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CONSUMPTION TAXES

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CONSUMPTION TAXES

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LAW AND CONTEMPORARY PROBLEMS

VOLUME VIII | SUMMER, 1941 | NUMBER 3

FOREWORD

Federal and state taxation of income, state and federal exactions on business enterprise, state and local taxation of property, and federal and state duties on successions, gifts and transfers—all these forms of modern taxation have in recent years received attention ranging from the most elaborate to at least a satisfactory minimum. Not so with those taxes which, measured either by physical volume of goods flowing into consumer hands, or by consumers' money outlay, fall more upon the economic process of consumption than upon production, property or income. Treatments there have been, of course, from time to time; yet textual discussion remains both scarce and often generalized, casebooks all but disregard such taxes, periodical comment is marked by its paucity, relevant decisions and administrative rulings are tucked away beyond the reach of many, and, all in all, the area has been left to shift as best it may in the mad scramble to decode the intricacies of other aspects of the complex taxing systems of today.

Nevertheless, consumption taxes now represent a significant part of the total yearly tribute that is Caesar's; indeed, taxes of this denomination will not uncommonly exceed in fiscal productivity the yield from more established sources. A comparative latecomer, especially in the states and local political subdivisions, consumption taxation can no longer be cavalierly dismissed as a transient interloper. It is here to stay as an effective further mode of raising the vast sums of public monies necessitated by Government's ever-expanding role. Beyond this, this species of tax, pressing on the economic arteries of the body politic, is peculiarly available for effectuation of the rising philosophy of socio-economic control through tax techniques, whether the nation be at war or peace. Its place in the taxing systems of tomorrow is thus doubly guaranteed.

These considerations would seem amply to warrant an inquiry into the problems raised by introduction of consumption taxation as a major taxing device. Especially is this true in view of the fact that in so many particulars does its introduction involve issues of an economic, fiscal and technical character wholly or largely absent from the application of other major forms of taxation. The field itself, ill-defined as yet, requires careful delineation; so also must careful consideration be accorded the question of the balance preferably to be struck between the newcomer and more established methods of raising public revenues. Taxation at the consumption stage brings crucial problems in economic impact, even apart from the dynamics of intended shaping of economic and social ends. And both the character of consumers' taxes

and the circumstances of resort to them produce, on the state level at least, hard questions of revenue disposition as well as of revenue realization.

Revenue realization itself precipitates many a problem as the principle of consumption taxation is translated into rules of day-to-day administration. To be met—and somehow conquered—are jurisdictional and commerce limitations on both power to tax and power to collect; internal tax collection from a host of taxpayers, unaccustomed to the function, demands an administrative technique all its own. Definition of an unfamiliar kind of taxable transaction, complicated by the utilization of new bases of measurement, and vexed by the necessity of successful assimilation of constitutional and statutory pressures for exclusion and exemption, lest the Jonah of liability be swallowed up by a whale of exceptions, put administration further to the test. Federal experience offers partial guidance and example; yet for the pioneering municipalities especially, such aid is offset by difficulties unique to them. To a critical analysis and evaluation of consumption taxation and its train of problems, insofar as such a program can be fulfilled within a periodical's pages, this symposium is devoted.

FRANK R. STRONG.

CHARACTERISTICS, DEVELOPMENTS AND PRESENT STATUS OF CONSUMPTION TAXES

Paul Studenski*

Many and varied are the classifications of taxes devised by scholars in the past, but nearly all of them agree as to the existence of a category of exactions conveniently denominated as "consumption taxes." Hobbes, writing in 1651, in his *Leviathan,* distinguished taxes levied on citizens "according to the rate of what they spend." So did Petty in 1662 in his *Treatise of Taxes and Contributions.* Similarly, practically every important work on taxation published in any language during the past three centuries has treated taxes on consumption as falling within a separate economic category.

German students of public finance of the nineteenth century (Wagner, Cohn and others) classified taxes in three groups according as they were levied, respectively, on wealth in the process of acquisition, wealth in possession, and wealth in the stage of consumption. The first group in this classification would embrace business, general turnover, and severance taxes; the second, property, income, and possibly inheritance taxes; and the third, consumption taxes. The threefold classification is useful for economic analysis, even though not for practical administrative purposes.

But even more enlightening, from an economic point of view, is de Viti de Marco's suggested threefold classification of taxes[1] into (1) direct taxes on the income produced or the sources thereof, such as personal income taxes, taxes on specified types of income and taxes on real and personal property and business enterprise, (2) indirect taxes on the income consumed, embracing mainly excise and customs duties, and (3) indirect taxes on the income saved, including mainly taxes on transfer of property, gifts, and successions.

In his classification of taxes, de Marco starts with the premise, the correctness of which is undeniable, that all taxes are normally paid out of incomes earned in cur-

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[1] De Viti de Marco, First Principles of Public Finance (1936) c. 8.

rent production. Even taxes which are formally levied on the ownership of capital are paid in reality out of the income. "A tax, the continuing payment of which, in fact, consumes part of an individual's capital, is absurd," he rightly says, "because, even if we assume that it may exist, it would impoverish and ultimately exhaust the source of public revenues and would lead to the gradual disappearance of the State that levies such a tax."[2]

The direct taxes on income produced, according to de Marco, should be supplemented by indirect taxes on the income disposed, *i.e.*, on its consumption and its saving so that any possible concealment or undervaluation by the taxpayer of his income at the time of its production, may be corrected subsequently at the time of its disposition and the complete equality and rationality of the tax system, as a whole, insured. Indirect taxes, he insists, result not in the double taxation of the same income, but in a more effective taxation of it.

The present writer prefers a fourfold classification of taxes, made according to their economic characteristics, into (1) taxes on income in the process of production previous to its breakdown into differentiated shares to the various participants in production, represented by various business and occupational taxes; (2) taxes on income distributed, represented by the personal income tax and by the various classified or objective income taxes applicable to different types of income, such as salaries, wages, profits, dividends, interest, and net rent; (3) taxes on income consumed, as defined above, and (4) taxes on income saved, *i.e.*, duties on successions, gifts and transfers of property.

Recently in this country, however, some writers on public finance, such as Lutz, Buehler, Clyde King, Hunter and others have omitted the category of consumption taxes from their classifications of taxes, substituting groups called "commodity taxes" or "selected and general sales taxes," which are not altogether identical with it. They have done so on the grounds that it is generally impossible to determine whether a tax on a given commodity falls on its consumption or on its production, since the forces determining the incidence of taxation work in an uncertain way, and that certain property taxes infrequently may likewise fall on consumption. These writers appear to have misunderstood the substance of consumption taxes which consists not so much in the fact that these taxes are in the final analysis borne by the consumers, as in the fact that they are *intended* to be borne by them. For, in the final analysis, all citizens are consumers and consequently all taxes fall upon consumers in some way or another. This fact does not mean, however, that all taxes are consumption taxes, nor does it mean that no particular taxes can be called by that name. Taxes are never classified on the basis of their incidence. They are usually classified on the basis of their more apparent characteristics. One of the most useful classifications is that which has reference to the capacities in which taxes affect individuals and the manner in which they are apportioned among them. This classification distinguishes between property taxes, which strike at individuals in their

[2] *Id.* at 213.

capacities of property owners and in proportion to their property ownerships; business taxes, which reach individuals in their capacities of businessmen and are adjusted to the peculiarities of their business operations; consumption taxes, which strike at individuals in their capacities of consumers and are apportioned among them in accordance with the nature and extent of their consumption; personal income taxes, which deal with individuals as recipients of income and are apportioned among them in accordance with the size of their incomes; and a few other such categories of taxes. The fact that property taxes affect consumers does not make them consumer taxes, any more than the fact that consumer taxes affect property owners makes them property taxes.[3]

THE FIVE DISTINGUISHING CHARACTERISTICS OF CONSUMPTION TAXES

The foremost distinguishing characteristic of consumption taxes, as suggested above, is that they are levied on individuals as consumers rather than as producers, property owners, or simply recipients of incomes, and are adjusted to their consumption habits rather than to their productive activities, property holdings, or incomes. Thus, they are applied, as a rule, to certain selected types of consumption and not to others, the selection or exemption being based in each case upon a variety of considerations, which it is not necessary here to review in detail. Suffice it only to say that among such considerations, the desire to curtail certain types of consumption deemed injurious to public health, morals, or welfare, or not to interfere with others deemed essential thereto, frequently plays an important part.[4]

The second important characteristic of consumption taxes is that they are made to vary in amount with the character and extent of consumption expenditures of individuals. Persons consuming a large quantity of taxable services or goods pay a correspondingly larger amount in such taxes than do those consuming a small quantity of them. By changing their consumption habits, individuals may alter the amounts of consumption taxes they have to pay.

The third characteristic of these taxes is that they apply only to the spendable portions of the incomes of individuals and spare the saved parts thereof, and that they tend to be regressive, inasmuch as the poor spend larger proportions of their incomes on consumption than do the rich. The regressivity of the consumption taxes, however, must not be exaggerated, nor does it necessarily condemn them. First of all, it is possible to construct a system of consumption taxes which would apply proportionately to the spendable portions of all incomes, if not to the entire incomes. Secondly, the gap left open in their proportionate application can be closed

[3] Lutz fails to realize this when he says, "It is equally true that a tax on the retailer's stock of merchandise as personal property is a tax on consumption." He is in error when he considers the distinction between consumption taxes and property taxes to be fictitious and meaningless. LUTZ, PUBLIC FINANCE (3d ed. 1936) 568.

[4] See, on this latter point, the discussion by Hart, *Consumption Taxation as an Instrument of Economic Control, infra* this issue; on exemption policy generally consult Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes;* Conlon, *Express or Implied Exclusions from Consumption Taxes—Types of Consumers,* both *infra* this issue.

effectively by the imposition of progressive income and property transfer taxes, which fall mainly upon the portions of income that are intended to be saved. The chief function of the consumption tax in modern times is normally to reach incomes which are exempt under the personal income taxes, and thus to round out the tax system and to make it more universal and more productive of revenue. Its secondary function is to reach proportionately, as far as possible, the entire spendable portions of incomes, be they large or small, and thus to make the tax system more equitable.

The fourth characteristic of consumption taxes is that they generally are imposed on the act of sale or purchase of the articles or services to be consumed, are collected from the vendors, and are expected to be passed on by the latter to the consumers in the form of higher prices. They are, therefore, indirect in character. It would be impractical in most cases for the state to try to collect the taxes directly from each individual consumer on each separate act of consumption. It is generally necessary to apply the tax before the consumption takes place, as the article leaves the vendor. The taxes are levied on the acts of sale or purchase because at this point the articles or services in question pass from the production to the consumption stage and their quantity and value can then be most easily ascertained.[5] The vendors are used as collecting agents because the consumable goods concentrate at their places, and collection can therefore be effected there on a mass scale. Not infrequently, special devices are employed by the state to insure the shifting of the taxes by the vendors to the consumers and to make the latter conscious of their imposition. To that end, either the vendors are required to add the tax to the price by entering it separately on the customer's bill or affixing a revenue stamp to the article; or else, the consumers are compelled to pay the taxes to the vendors with special token money issued by the state for the purpose.[6]

Only a very few consumer taxes are collected by the state directly from the consumers and consequently classifiable as direct. Such are the taxes levied on the use of durable commodities, such as carriages, automobiles, living quarters, pianos, billiard tables, clocks, or imposed on the employment of servants or the keeping of dogs; that is, uses which involve substantial and more or less conspicuous consumption. Consumption taxes form the bulk of the indirect taxes, the only other taxes belonging to this group being miscellaneous transactions taxes, protective customs duties, taxes on transfers of property, gifts and successions, and a few other miscellaneous exactions.

The fifth characteristic of consumption taxes is that they are imposed on goods and services in a finished state and at a point in the productive and distributive process which is fairly close to the consumer, such as the retailer's, wholesaler's, or,

[5] For discussion of measure see Ratchford, *The Measure of Consumption Taxes*, *infra* this issue. For analysis of the problems involved in levying on sale or purchase, see Herman, *Who Are Taxable?—Basic Problems in Definition Under the Illinois Retailer's Occupation Tax Act;* Cohen, *The Taxable Transaction in Consumers' Taxes;* Wahrhaftig, *Meaning of Retail Sale and Storage, Use or Other Consumption, all infra* this issue.

[6] On collection devices see Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes, infra* this issue.

at the most, the manufacturer's sale of the objects in question. The imposition of these taxes on goods and services ready for consumption rather than on raw materials or other producer goods permits the introduction of differentiations in their rates of imposition in accordance with differences in the qualities of consumer goods and services and in the uses made of them. The collection of these taxes at a point in the productive and distributive process not far removed from the consumer facilitates the shifting of these taxes to him, inasmuch as it reduces to a minimum the number of places at which frictions interfering with shifting may occur.[7]

SCOPE AND DEFINITION OF THE CONSUMPTION TAX FIELD

Delineation of the distinguishing characteristics of consumption taxes provides a basis for defining the field of these taxes. It must, first of all, include internal taxes, or "excises" as they are generally called,[8] on various consumer commodities, such as liquor, tobacco, sugar, soft drinks, salt, yeast, playing cards, cosmetics, automobiles, gasoline and narcotics, and also on consumable services, such as amusements, travel, betting, lotteries, hotel and restaurant services, telephone service, and the like. The field must also include the so-called "use taxes" on automobiles, carriages and other durable goods, and taxes on living quarters, maintenance of servants, keeping of dogs, and like things, since they possess most of the characteristics of consumption taxes and resemble very closely the "excises." But it should probably not include agricultural processing taxes which are intended to help farmers to secure better prices without regard to whether the processors or the consumers may have to pay them. These taxes have more the characteristics of production, or business taxes, than of consumption taxes.

Secondly, the list of consumption taxes must include duties on the imports of various consumable products, such as wines, liquor, sugar, coffee, tea, cocoa, spices, and the like. It is debatable whether it should include also duties on the imports of raw materials, such as wool, cotton, silk and iron, which are not definitely intended to be borne by the ultimate consumers of the finished articles produced therefrom, but are considered equally appropriate if they should fall on the manufacturers producing the finished articles. Export duties should be excluded from the list of consumption taxes, since they do not affect domestic consumers but are aimed at either the domestic producers or the foreign consumers.

A question may also be raised as to whether purely protective import duties belong to the class of consumption taxes. For, although they are intended to raise the prices of the imports to the consumers and to prompt them to buy domestic goods in preference to the foreign ones, yet, at the same time, they are also intended to alter the pattern of domestic production. Both in the selection of the objects for

[7] Martin, *Distribution of the Consumption Tax Load, infra* this issue, considers the intricacies of consumption-tax shifting.

[8] The word "excise" comes from the Latin *excisio* which means "cutting out," and refers to the fact that a part of the price charged the consumer goes to the State. The use of this term in England dates very largely from the year 1643 when the Long Parliament enacted a comprehensive system of excise duties. But this term came into official use in Holland even earlier.

their imposition and in the fixing of their rates, prime attention is given to costs of production, prices of products and other such characteristics of the businesses involved. The burdens of the tax (or subsidy offered to the protected industries) are placed upon other industries and occupations. Since the protective duties thus take into account the characteristics of both consumers and producers, they embrace features of both consumption and business taxes and are on the borderline of the two.

Thirdly, the class of consumer taxes should include the three main categories of general sales taxes, namely, the retail sales tax, the wholesaler's sales tax, and the manufacturer's sales tax. For these taxes are definitely intended to be borne by consumers in proportion to their consumption, being collected from retailers, wholesalers, or manufacturers merely for reasons of convenience. The intention not to make these taxes a burden on the dealers or manufacturers is generally evidenced by the fact that the sales of the products as between retailers, in the case of a retail sales tax, or as between wholesalers, in the case of a wholesaler's sales tax, or as between manufacturers, in the case of a manufacturer's sales tax, are specifically exempted from the levies in question. Their character as consumption taxes is evidenced further by the fact, already stated, that certain types of goods considered as being essential to a minimum of subsistence are frequently exempted from their application.

It would be scarcely proper, however, to include among consumption taxes, general turnover taxes or gross income taxes applied at every stage of production and to every type of exchange. Nor would it be proper to place in this category the tax on "value added" by production, *i.e.,* a tax on the gross receipts of an enterprise less the costs of materials and services purchased by it from other enterprises. For these taxes are definitely geared to the peculiarities of business operations and vary in amount in accordance therewith. They affect the producers much more intimately and directly than they do the consumers. Clearly, these types of exaction belong to the category of business taxes.

In the fourth place, the list of consumption taxes should include the net profits of fiscal monopolies engaged in the manufacture or distribution of consumable products ordinarily subjected to excise taxation, such as liquor, tobacco, sugar, salt, matches, and the like. These monopolies are established, as a rule, for the purpose of deriving a net revenue for state purposes from the sale of the products in question. The net revenue earned by them is, therefore, tantamount to a consumption excise.

In the fifth place, the list of consumption taxes should include the so-called "octroi" duties, which are levied in some European countries at the city gates on goods brought in from country districts. They are excises on the food of the urban populations, collected from the vending farmers.

CLASSIFICATION OF CONSUMPTION TAXES

Consumption taxes may be classified in various ways. According to their relation to the subjects taxed, they must be distinguished as (1) direct, *i.e.,* collected directly

from consumers and (2) indirect, *i.e.*, collected through vendors. The first group, as already mentioned, applies, as a rule, to the purchase or use of durable, relatively costly and easily ascertainable goods and services, such as automobiles, carriages and horses, living quarters, furniture, and servants. The second group covers the bulk of consumer taxes.

According to their scope, consumer taxes should be classified as (1) general consumer taxes, such as general retail, wholesale, manufacturer's sales taxes, and (2) selective or special consumer taxes, such as liquor excises, tobacco excises, gasoline taxes, and special "use taxes."

On the basis of the economic characteristics of the consumption involved, *i.e.*, the urgency of the wants served thereby, the consumer taxes should be classified as (1) those levied on necessities, such as bread, yeast, salt, starches, meat, vegetables, soap, shoes, clothing, matches, candles, fuel, and so on; (2) those levied on semi-luxuries, such as liquor, tobacco, sugar, coffee, tea, cocoa, amusements, low-price automobiles; (3) those levied on luxuries, such as cosmetics, perfumery, jewelry, furs, carriages, servants, finer qualities of wines, expensive types of automobiles; and (4) those levied on objects of harmful consumption, such as narcotics. Manifestly, a classification of this type must be flexible. It must be adjusted to the peculiar standards of living of the population of the given country at the given time. For an item of consumption which at one period in the development of a country is considered to be a luxury available only to the rich, at another period assumes the character of a semi-luxury available to nearly all the people, or even of a general necessity. Similarly, some commodities which in one country belong to the class of luxuries, in another belong to the class of necessities.

Classification on the basis of the physical characteristics of the objects taxed would divide consumption taxes into those levied on (1) foods, (2) beverages, (3) other goods, and (4) services. This classification is used in a number of foreign treatises, but it is not particularly illuminating.

According to their administrative characteristics consumption taxes should be classified as (1) internal duties, or excises, (2) customs duties, (3) fiscal monopolies and (4) "octroi duties."

Finally, according to the objects of their levy they should be classified into (1) those levied primarily for revenue purposes and (2) those levied primarily for purposes of control of the consumption involved, *i.e.*, for the safeguarding of public health and morals. Some of the latter taxes are sometimes called "sumptuary taxes."

HISTORICAL DEVELOPMENT

Historically, customs duties have preceded the excises. In fact, they constitute probably the oldest form of taxation. "They seem to have been called customs," says Adam Smith,[9] "as denoting customary payments which had been in use from time immemorial. They appear to have been originally considered as taxes upon

[9] SMITH, WEALTH OF NATIONS (1776) Bk. 5, c. 2, Pt. II, art. 4.

the profits of merchants." Within the sphere of internal taxation of consumption, direct levies on consumers have preceded the indirect ones. They developed in part out of the system of taxation of personal property and originated in the sentiment responsible for the enactment of various sumptuary laws aiming at the repression of luxurious expenditures.[10]

The indirect internal taxes on consumption are relatively modern. The Dutch and English excises are only three hundred years old, and the corresponding branches of revenue in other countries are even more recent. This type of taxation had its historical roots in the prerogatives of the feudal overlords as expressed in market fees and tolls and in customs duties, and it could develop only when production for one's own consumption gave way largely to production for exchange and when monetary transactions became all-pervasive. "Any attempt to tax producers or dealers in the expectation that they will recoup themselves by charging an increased price for their wares," says Bastable,[11] "is obviously impracticable when most production is for domestic use, and such exchanges as do take place are transacted by means of barter." Moreover, it was natural that the internal taxation of consumption should have been preceded by the external one, since customs duties were easier to collect and were believed to be falling mainly on foreign producers. A further prerequisite for the creation of an extensive system of excises, as Bastable observes in the course of the same discussion,[12] was the "formation of an administrative organisation capable of effectively supervising the production of the dutiable articles within the territory of the State."

The early forms of excises were extremely oppressive in character, since they were applied as a rule to prime necessities like salt, vinegar, candles and coal, were imposed at rates manifoldly increasing the prices of these articles to the consumers and were collected frequently through unscrupulous private agents interested only in deriving the utmost profit for themselves from their collection and treating the taxpayers in a most high-handed fashion.[13] As a result, the consumption taxes became so unpopular in the middle of the eighteenth century that their further spread was halted for a while. In England, a popular cry arose, "no slavery, no excises, no wooden shoes." Dr. Johnson defined the excise as "a hateful tax levied upon commodities and judged not by common judges of property, but by wretches hired by those to whom excise is paid." Walpole dropped a proposal to extend the excises, saying "I will not be a minister to enforce taxes at the expense of blood." In America, the colonists rebelled against the introduction of an imperial system of internal excises. In France, one of the first acts of the Revolution was to repeal all excises.

But the State could not get along without consumption excises. Nor did fiscal

[10] BASTABLE, PUBLIC FINANCE (3d ed. 1903) Bk. 4, c. 6. [11] *Id.* at 505. [12] *Ibid.*

[13] The classical example of a tax levied at exorbitant rates is the tax on salt. Levied in England through the salt monopoly in the beginning of the seventeenth century, it raised the price of salt from 1*s.* 4*d.* to 15*s.* per bushel. The rate of the tax was lowered towards the end of the century, only to be raised again drastically a hundred years later. At 10*s.* per bushel, the rate of tax in 1798, it was thirty times the cost of production, which was only 6*d* per bushel. SHIRRAS, THE SCIENCE OF PUBLIC FINANCE (1925) 379.

justice really require that it give them up. The trouble with the existing excises was not that they were inherently unjust, but rather that they were improperly organized, and were levied under unfavorable social, economic and political circumstances. When the excises were reorganized in the nineteenth century and, at the same time, the political, social and economic atmosphere cleared up, the excises proved quite acceptable to the general public and suitable for a more extended use by the State. In France, the consumption excises were restored on a reformed basis within a few years from the time of their abolition by the Revolution, and were refined considerably during the following several decades. In England, the excises were freed of their most objectionable features during the second quarter of the century. In practically every country the consumption excises were overhauled fundamentally and developed along more acceptable lines.

This reorganization of consumption taxes during the nineteenth century took several directions. First of all, the taxes on necessities, such as salt, candles, leather, starch, yeast, soap, paper, and glass, and the duties on the foodstuffs of the urban populations were either repealed outright or were greatly moderated as to their rates. The excises were concentrated, instead, on a few articles of general, but not indispensible consumption, comprising the luxuries of the common people—liquor, beer, tobacco, sugar, tea, coffee, playing cards, lotteries and betting. Secondly, the vicious system of exemption of certain privileged groups of society from the payment of the excises, inherited from feudal times, was abolished. Thirdly, the system of collection of the excises was simplified, made more effective and also less expensive through the organization of collection at the points of manufacturing or wholesaling of the articles in question, where they could be found in greatest concentration, easily recorded and appraised, and where the taxes could be collected in bulk. In some cases, new fiscal monopolies were organized for the more effective collection of the revenue or the existing monopolies were reorganized on a more efficient basis. In the fourth place, the administrative personnel charged with the collection of the excises was improved through the substitution of a fixed compensation for the old system of payment of commission or fees for the work, introduction of a system of appointment and promotion on the basis of merit, elimination of graft and other like reforms.

By attaching the excises to articles which were either rapidly coming into general use and, when used in moderation, constituted an important element in a rising standard of living, or which, when used to excess, were harmful to the individuals, the State was not only raising necessary revenue in a relatively fair and painless way, but was, moreover, raising it on an ever-expanding scale. For the burdens of these excises were being easily absorbed in most countries in the rising standards of living resulting from the rapid industrial development occurring there at the time. They were also absorbed, in part, in the reduction in the prices of the articles in question resulting from the fact that they were produced now in huge quantities and, hence, at lower costs. Thus, although the excises were regressive so far as the entire population, including the rich, was concerned, yet within the broad confines of the middle and lower income groups they bore a relatively fair relation to incomes.

With the further rise in the standards of living of the population in the present century, the excises were extended to such newly popularized articles and services as motion pictures, automobiles, gasoline, radio, soft drinks, chewing gum, patent medicines, cosmetics, railroad travel and telephone service. At the same time, during the first World War, or the period immediately thereafter, a number of countries, in consequence of a pressing need for additional sources of revenue, introduced either general manufacture, wholesale and retail sales taxes, belonging to the category of consumer taxes, or general turnover taxes which, in part at least, fall within this tax category.

PRESENT STATUS OF CONSUMER TAXES IN THE TAX SYSTEMS OF THE WORLD

A glance at Table I reveals that consumption taxes at the present time normally furnish in most countries between 30 and 50 per cent of the combined national and

TABLE I

RELATIVE IMPORTANCE OF CONSUMER TAXES IN THE REVENUE SYSTEMS OF 23 COUNTRIES DURING THE YEARS 1936-1938[14]

	Percent Ratios to Total National, State and Local Tax Revenues						
	NATIONAL CONSUMER TAXES			STATE AND LOCAL CONSUMER TAXES			
Countries	Customs Duties	Excises	Fiscal Monopolies (a)	General Sales	Excises	General Sales	Total Consumer Taxes
United States	2.3	11.4			10.7	3.6	28.0
Great Britain	20.8	13.7					34.5
Australia	23.7	12.0		5.8	6.9		48.4
New Zealand	24.8	8.4		8.1			41.3
Canada	10.9	6.0		19.8	7.7		44.4
Ireland	31.0	20.0					51.0
Union So. Afr.	18.0	6.0			5.0		29.0
Belgium	15.3	15.5			1.0		31.8
Denmark	11.9	19.8		2.5			34.2
Estonia	38.1	12.1	lm				50.2
Finland	39.5	13.0	l		7.4		59.9
France	15.0	11.6	1.0^{tlm}	6.6[b]	3.0		37.2
Germany	8.6	13.1	1.6^{lm}	5.7[b]	4.3	1.9[b]	35.2
Hungary	3.9	8.9	9.5	7.7[b]	2.7		32.7
Italy	7.0	13.7	13.1^{tmlx}	3.1[b]		7.4[d]	53.8
Latvia	16.0	11.9	16.0^{l}	2.5[b]			46.4
Netherlands	11.5	20.2	l		0.9		32.6
Norway	19.8	9.4	4.4				33.6
Poland	4.1	8.7	31.7^{tlmx}	4.2[b]	1.7	1.6[b]	52.0
Sweden	33.1	11.0	t		0.8		45.6
Switzerland	27.0	4.0	1.4^{lx}		3.6		36.0
Turkey	16.5	10.0[c]	12.2^{tlmx}	4.2[b]			42.9
Yugoslavia	9.7	12.4	22.5^{tlmx}		6.0		50.6

(a) The letters below designate the character of the monopolies: t = tobacco; l = liquor; m = matches; x = salt.

(b) This is a general turnover tax. Only one-half of its revenue yield has been included, on the theory that the other half belongs to the field of business taxation.

(c) Estimated.

(d) Octroi duties.

[14] Based on figures compiled by the author with the assistance of the Works Progress Administration and published in TAX SYSTEMS OF THE WORLD (8th ed. 1940).

local revenues. The lowest proportion among the 23 countries covered by the table is found in the United States, where it is 28 per cent; the highest obtains in Finland, where it is 60 per cent. Other countries with a very high proportion of consumption taxes, ranging between 50 and 52 per cent, are Ireland and, before their absorption by Germany and Russia, Poland, Estonia and Yugoslavia. In preparing these figures the entire revenue from customs duties has been included on the assumption that the greater part of it has been collected under duties of fiscal or semi-fiscal types. It proved impossible, owing to lack of data, to break down the tariff revenue exactly into the consumption and non-consumption tax portions. So far as the revenue from general sales taxes is concerned, there are included in the figures the entire proceeds of manufacturers, wholesalers and retailers sales taxes, but only half the revenue of the general turnover taxes on the assumption that the latter taxes are partly consumption and partly business taxes.

The consumer taxes shown in Table I are predominantly national in character, local excises furnishing only a relatively small proportion of the total tax revenues represented in the table. General turnover taxes, although very recent, play a very

TABLE II

SOME OF THE OBJECTS TAXED INTERNALLY OR THROUGH CUSTOMS DUTIES IN 23 COUNTRIES

Countries	Liquor	Tobacco	Sugar and Sweets	Amusements	Automobiles	Gasoline	Betting and Lottery	Matches and Lighters	Salt	Consumer Goods Generally
United States	X	X	X	X	X	X				
Great Britain	X	X	X	X	X	X	X	X		
Australia	X			X	X					X
New Zealand	X			X	X	X	X			X
Canada	X	X	X	X	X	X	X	X		X
Ireland	X	X		X						
Union So. Afr.	X			X			X			
Belgium	X			X	X		X			X
Denmark	X	X	X	X	X	X	X	X		
Estonia	X	X		X	X	X		X		
Finland	X	X	X		X			X		X
France	X	X	X	X	X	X	X	X	X	X
Germany	X	X	X	X	X	X	X	X	X	X
Hungary	X	X	X			X	X	X	X	X
Italy	X	X	X	X	X	X	X	X	X	X
Latvia	X	X	X			X		X		X
Netherlands	X	X	X	X	X				X	X
Norway	X	X	X	X	X	X				X
Poland	X	X	X		X	X	X	X	X	X
Sweden	X	X		X	X	X	X			
Switzerland	X	X	X	X	X				X	
Turkey	X	X						X	X	X
Yugoslavia	X	X				X		X	X	

important part in the revenue systems of many countries even when as in the present compilation only a half of their revenue yields is considered. Fiscal monopolies are more prevalent among agricultural than industrial countries. The latter seem to prefer to collect the corresponding revenues from their consumers through the levy of excises.

Every country, as shown in Table II, is taxing liquor in some form or another. Nearly every country levies taxes on tobacco, sugar, amusements, automobiles, and gasoline. A number tax lotteries and betting, and matches. Less than half of the countries covered by the table are taxing salt; only one, Italy, taxes grain, a prime necessity.

Table III reveals in considerable detail the pattern of consumer taxes for four countries—the United States, Great Britain, Germany, and Italy. It will be observed that the proportion of revenue supplied by these taxes is relatively high in Italy (45.1%), comparatively moderate in Great Britain and Germany (35%), and rather low in the United States (28%).

TABLE III

RELATIVE IMPORTANCE OF VARIOUS CONSUMPTION TAXES IN THE REVENUE SYSTEMS OF FOUR COUNTRIES IN 1936-1938[15]

Types of Consumption Taxes	Revenue Yields in Millions of National Currency				Percent Ratio to Total National, State and Local Tax Revenue			
	United States 1938-1939 $	United Kingdom 1938-1939 £	Germany 1936-1937 Rms.	Italy 1937-1938 Lira	United States	United Kingdom	Germany	Italy
Liquor	843	105	799(*)	200	6.1	9.6	5.1	.8
Tobacco	660	85	999	2560	4.8	7.7	6.4	10.4
Sugar	109	14	330	1100	.8	1.3	2.1	4.5
Coffee, Tea, Cocoa		12	300	430		1.2	1.9	1.8
Automobiles	435	37	135	155	3.1	3.4	.8	.6
Gas and Oil	1041	58	450	1000	7.6	5.3	2.9	4.1
Railroad Travel			136	250			.9	1.0
Amusements	41	8	43		.3	.7	.3	
Lottery and Betting			30	426			.2	1.7
Matches and Lighters		4	31	120		.4	.2	.5
Salt			61	321			.4	1.3
Meats and Fats			497				3.2	
Grains				60				.2
General Sales	490		1200	650	3.6		7.6	2.7
Octroi				1829				7.4
Miscellaneous	233	53	489	2001	1.7	4.8	3.1	8.1
Total Consumption Taxes	3,852	376	5,500(*)	11,102	28.0	34.4	35.2	45.1
Total National, State and Local Taxes	13,795	1,091	15,636	24,604	100	100	100	100

(*) Estimated.

[15] Compiled from figures prepared by the author with the assistance of the Works Projects Administration and published in TAX SYSTEMS OF THE WORLD (8th ed. 1940), brought to date on the basis of official reports of the countries involved.

Liquor taxes supply a higher proportion of the total tax revenue in Great Britain (9.6%) than in the other three countries. This fact can be explained by the higher rates at which these taxes are imposed in Great Britain rather than by any greater consumption of liquor by the population of that country. The proportion of revenue supplied by liquor taxes in Italy, really taxes on wine, is extremely low. Since the production of wine is carried on in Italy by the people largely in their own homes, its consumption does not lend itself readily to taxation by the State.

On the other hand, tobacco furnishes a larger proportion of the total revenue in Italy than in any of the other three countries. By taxing heavily the consumption of this article, through a fiscal monopoly, the Italian State compensates itself for its inability to reach the incomes of the population through the taxation of their consumption of alcoholic beverages. Curiously enough, the United States obtains a smaller proportion of its revenue from the taxation of liquor than do the other three countries. Taken together, liquor and tobacco consumption taxes normally supply the largest proportion of revenue in Great Britain (17.3%), and only 10 to 11 per cent in the other three countries.

The taxation of automobiles supplies approximately three per cent of the revenue in the United States and the United Kingdom, but less than one per cent in Germany and Italy, thus reflecting the more extensive utilization of motor vehicles in the two first-mentioned countries. The taxation of gasoline and other oil products similarly supplies much greater proportions of revenue in the first two countries than in the other two.

Railroad travel is taxed substantially in Germany and Italy, but is free from taxation in the United States and Great Britain. The taxation of amusements supplies less than one per cent of the revenue in the United States, Great Britain, and Germany, but is not represented in the tax system of Italy. The taxation of lotteries and betting, on the other hand, which belong to the class of amusements, furnishes almost two per cent of the Italian revenue.

The taxation of matches and salt produces approximately one to two per cent of total revenue in Germany and Italy. In addition, taxes on meats and fats furnish three per cent of the revenue in Germany and the local octroi duties which apply to foodstuffs generally, supply over seven per cent of the revenue in Italy. All such necessities are practically free from taxation in the United States and Great Britain.

General sales taxes play a very important part in the revenue systems of Germany and Italy, but a relatively small role in that of the United States. They are not employed in any way in Great Britain, save that in 1940, a purchasing tax, limited in its application to luxuries, was introduced in that country as a part of the program of taxation for national defense.

It will be observed from this survey that the consumer taxes are in the United States and Great Britain limited, in the main, to a few articles associated with a relatively high standard of living of the population, but are spread in Germany and Italy over practically the entire field of consumption and bear quite heavily upon necessities. The field of consumption taxes, although quite old, is by no means out of harmony with the spirit of modern times. It has shown great adaptability to changing economic conditions and is here to stay.

THE PLACE OF CONSUMERS' EXCISES IN THE TAX SYSTEM

Dixwell L. Pierce*

"Taxes are fixed much as wages are fixed, by the play of competitive forces."[1]

Consumers' excises found a place in the federal revenue system more than one hundred and fifty years ago when the government of the United States imposed its first whiskey tax.[2] That was thirty years before Sydney Smith published his famous commentary on consumption taxes in the *Edinburgh Review*. Tracing the course of excises in the life of man, he wrote:[3]

> The school boy whips his taxed top, the beardless youth manages his taxed horse with a taxed bridle, on a taxed road; and the dying Englishman, pouring his medicine, which has paid seven per cent., flings himself back on his chintz bed, which has paid twenty-two per cent., and expires in the arms of an apothecary who has paid a license of a hundred pounds for the privilege of putting him to death—his virtues are handed down to posterity on taxed marble; and he is then gathered to his fathers to be taxed no more.

Improved amusements, transportation facilities, medication and, it is to be hoped, tax technique may have altered matters somewhat, but a modern Sydney Smith might still wax satirical in his comments on present-day taxes. Debating a proposed federal sales tax in the House of Representatives a few years ago, one of the members suggested that the epitaph for unfortunate "John Brown," an average citizen, might well close with these lines:[4]

> A tax attacked him when he was born,
> Attacked him till he felt forlorn,
> If they increase, as in this bill
> It won't be long until they will
> Impose a tax on growing corn
> And on the toots of Gabriel's horn.

* A.B., 1919, J.D., 1921, University of California. Secretary, California State Board of Equalization, since 1926; Deputy Attorney General of California, 1926. Member of the California Bar. Lecturer in law, University of California (1937); President, National Association of Tax Administrators (1938).

[1] Adams, *Ideals and Idealism in Taxation* (1923) 13 Am. Econ. Rev. 1.

[2] This was in 1790.

[3] Hoyt's New Cyclopedia of Practical Quotations (1922) 334.

[4] From a speech by Hon. Claude B. Parsons of Illinois, March 14, 1932.

Yet, much as excises have been criticized by economists, politicians and the public generally, the United States Government has relied mainly on consumption taxes for its support during the major part of its existence. This circumstance may be traced to the requirement in the Federal Constitution that no direct tax shall be laid unless it "shall be apportioned among the several states which shall be included within this union according to their respective number."[5] Federal property taxes were made impracticable by this restriction and, although income taxes were at first held not direct taxes,[6] a later decision of the United States Supreme Court reached a contrary conclusion.[7] Thus, it was not until 1913, following adoption of the Sixteenth Amendment eliminating the apportionment requirement in so far as income taxes are concerned, that this type of revenue was made practicable for the national government.

A rapid shift in revenue sources ensued. In 1910, 54 per cent of the federal collections came from customs, 33 per cent from liquor taxes, 9 per cent from tobacco taxes, and 3 per cent from corporation taxes measured by income.[8] By 1920, 69 per cent of the federal revenue came from income taxes, 6 per cent from customs, and 5 per cent from tobacco. Owing to prohibition, liquor excises had vanished and the remainder of the federal collections came from a variety of sources. Ten years later, income taxes were still responsible for more than two-thirds of the revenue of the national government. Meanwhile, customs had climbed back to 16 per cent of the total and tobacco taxes were accountable for 12 per cent.

Then came the depression. By 1935, although still the largest single federal revenue source, income taxes had shrunk to 36 per cent of total collections. Tobacco taxes represented 15 per cent, and, as result of the repeal of prohibition, were followed closely by liquor taxes at 13 per cent. Customs contributed 10 per cent; estate and gift taxes, 7 per cent; gasoline taxes, 5 per cent; with scattered sources making up the remainder.[9] Despite some upward fluctuation since 1935, the yield from income taxes in 1940 was still only 36 per cent of the revenues of the national government. Almost all of the remaining 64 per cent of federal collections for last year came from various types of excises. World War II had disturbed foreign trade so seriously as sharply to curtail customs receipts.

Expressed in millions of dollars, federal revenues, actual and estimated, for 1940, 1941 and 1942, may be summarized thus:

[5] U. S. CONST. Art. I, §2. See also *id.* §8.
[6] Springer v. United States, 102 U. S. 586 (1880).
[7] Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 158 U. S. 601 (1895).
[8] (April 1940) 4 TAX ADM'RS NEWS (No. 4) 25.
[9] *Ibid.* Figures are rounded to the nearest tenth of a million and will not necessarily add to totals.

TABLE I

FEDERAL REVENUES[10]

Source	Actual 1940	Estimated 1941	Estimated 1942
Income Taxes	2125.3	3055.0	4509.5
Other Internal Revenue:			
Liquor Taxes	624.1	810.5	839.5
Tobacco Taxes	608.1	691.9	716.6
Estate and Gift Taxes	360.1	348.6	374.5
Gasoline Taxes	226.2	360.6	389.2
Manufacturers' Excise Taxes	220.5	262.9	277.2
Capital Stock Tax	132.7	166.8	193.4
Miscellaneous Taxes	188.0	229.7	238.9
Total	2344.6[a]	2871.0	3029.3
Employment	838.1	898.0	968.5
Customs	348.6	302.0	295.0
Miscellaneous Revenue	268.2	527.2	169.4
Grand Total	5924.8	7653.2	8971.7

[a]Adjustment to daily Treasurer's statement basis (unrevised).

From these figures, it is apparent that the Federal Government is dependent upon excises, many of them of the consumption type, for a large part of its revenue and that this will continue to be the situation indefinitely.

Until recently, states have made relatively little use of consumers' excises in their tax systems.[11] When highway costs proved too great to be met from existing revenue sources, Oregon was first to enact a gasoline tax. In February, 1919, the legislature of that state passed a law authorizing the collection of a tax of one cent per gallon.[12] A similar federal tax had been proposed four years earlier when in 1915 President Wilson had suggested it to the Congress. However, no action was taken by the national government until 1932, when a provision imposing a federal tax of one cent became effective.[13] By that time, every state in the Union had adopted the gasoline tax as part of its fiscal system.[14]

No other excise is imposed with such universality throughout the nation. There are, however, tobacco taxes in twenty-eight states.[15] That the trend toward these taxes is still active may be deduced from the fact that five states added tobacco excises to their tax systems in 1939 and two as recently as 1941.[16] Federal tobacco taxes, although newly imposed in comparison with the whiskey tax of 1790, originated much earlier than the state excises on tobacco, since they were adopted as a war revenue measure in 1862.[17]

Confronted by a dilemma which arose from increasing demands upon government and diminishing returns from the usual sources of revenue, more than a score

[10] ANN. REP. SEC'Y TREAS. (1940) 147.

[11] GROVES, FINANCING GOVERNMENT (1939) 313.

[12] Ore. Laws 1919, p. 219.

[13] Revenue Act of 1932, §617.

[14] CRAWFORD, ADMINISTRATION OF THE GASOLINE TAX IN THE UNITED STATES (1930) 2.

[15] (May 1941) 5 TAX ADM'RS NEWS (No. 5) 54.

[16] (Nov. 1939) 3 *id.* (No. 11) 1; (April 1941) 5 *id.* (No. 4) 37; (May 1941) 5 *id.* (No. 5) 54.

[17] Hynning and Colm, *Taxation of Corporate Enterprise* (1941) T. N. E. C. MONOGRAPH No. 9, c. 9.

of American states resorted to general sales taxes in the early nineteen-thirties as a means of averting fiscal chaos. The exigencies of the situation precluded as thorough preparation for the tax as might have been desired. West Virginia and Georgia both had gross receipts taxes of general application prior to 1930,[18] but the pioneer state in the general sales tax field, if that appellation may be used with respect to a tax of such ancient origin, was Mississippi.[19] Discussing the law at the National Tax Conference in 1933, A. H. Stone, Chairman of the State Tax Commission, described the opposition to its enactment in these words:[20]

> The sales tax law of Mississippi was enacted with the frank declaration that it was in the nature of an emergency experiment. . . .
>
> From the fact that the proposed tax was technically a tax on business, arose most of the opposition which was manifested while the bill was under legislative consideration. The chief objection urged was that business was already subjected to all the taxes which it could bear, and should not be called upon to carry any additional tax burden. This argument was, of course, predicated upon the assumption that the tax could not be passed on to the consumer, since the law made no provision to this effect. Incidental to this was the further contention that any attempt to pass on the tax would drive business out of the state, either to mail-order houses or to adjoining states. This argument was addressed especially to the business interests of the border counties of Mississippi. Maps and figures were diligently used to show the population within trading-area distance of towns in adjacent states, and hence presumably within the influence of this particular appeal.
>
> One of the strongest non-technical arguments made against the bill was that no similar general retail sales tax law had ever been successfully tried by any other state, and hence it could not be fairly assumed that such a law could be made effective for raising revenue in Mississippi. Another argument strongly urged was that the administration of such a tax would be burdensomely expensive. There is no question but that a successful administration of the act was by no means a certainty, when, after a long legislative struggle, it was finally passed. The bill was approved April 28, 1932, to become effective May first.

Commenting upon the fiscal situation which had preceded enactment of the sales tax, Mr. Stone continued:[21]

> Like most American states, Mississippi had been living beyond her income. The state's general fund revenues had equalled its general fund disbursements only six times in thirty years. The state's credit was impaired to such an extent that it could sell no bonds for any purpose whatever. Millions of dollars of state warrants were outstanding against an empty treasury. Real and personal property values had kept pace with the general decline, and any increase in revenue from general property taxes was an unthinkable suggestion. Conditions might conceivably have been worse, but only through the exercise of all the functions of a vivid imagination.

Adverting to the significance of the sales tax as a means of replacing other forms of taxation, particularly *ad valorem* taxes on property, Mr. Stone had this to say:[22]

> The question asked more often than any other in connection with the Mississippi sales tax is as to its effect upon other taxes. "Has it reduced the tax on property?" "Will it lighten the tax burden on homes and farms?" There is, of course, no possible categorical

[18] JACOBY, RETAIL SALES TAXATION (1938) 52, 69. [19] *Id.* at 61.
[20] Stone, *The Mississippi Sales Tax* (1933) 26 PROC. NAT. TAX ASS'N 223, 224.
[21] *Id.* at 225-226. [22] *Id.* at 226-227.

reply to questions such as these. I have stated that the sales tax was resorted to as a means of bridging a gap of $2,000,000 annually in the revenues estimated to be necessary to meet the state's operating expenses, after reducing appropriations about one-third. The sales tax, in meeting this revenue deficit, thereby rendered unnecessary an increase of at least four mills, possibly six mills, in the general levy on all classes of property, including homes and farms. Therefore, it may be said to have automatically effected the equivalent of at least a two-million-dollar annual reduction in taxes under the general levy. But no specific form of tax will ever, of itself alone, accomplish the end which all of us desire, but which those of us charged with administrative responsibility know is so difficult to attain. No substantial reduction in the tax burden can be realized except through a substantial reduction in governmental costs, combined with a more efficient and effective administration of the entire tax structure.

As long as the public demands increased and better school facilities, better provision for institutions of higher learning, better facilities and service for the defective and unfortunate groups, larger provision for veterans of wars, and all of the other things which the public does demand—just so long will the granting of these things determine the level of the tax burden which has to be borne in order that they may be enjoyed. And another thing; just so long as good citizens fail or refuse properly to return their property for tax purposes, either as to value or amount, just so long will tax rates remain high and tax equalization remain a farce. The process of shifting the tax burden, no matter how skillfully and adroitly it may be done, can never of itself accomplish a lessening of the total tax load.

At the conclusion of his remarks, Mr. Stone stressed that the sales tax had been, in the main, paid by the consumer, and that public understanding of the purpose of the tax is of great importance to its successful retention in a revenue system. Confining his observation to Mississippi, he said that his experience had convinced him that there is no logical reason why the sales tax should not be made a permanent part of a system of state revenues. Finally, he stressed the need for a comprehensive audit program in sales tax enforcement, saying:[23]

The most important factor in administration, next to public understanding and cooperation, and closely related to both, is a competent field force, adequate in number and sympathetic in an attitude which is genuine and not assumed. Without such field service, I would consider a successful administration of such a tax law as impracticable if not impossible.

At the time that the Chairman of the Mississippi Tax Commission was speaking, October, 1933, general sales or gross income taxes were imposed in twelve other states.[24] By the end of the following year, 1934, two more states[25] and the largest city in the country[26] had adopted sales taxes. Meanwhile, the New York state sales tax, imposed under an emergency act, had ceased to apply.[27] In 1935 six additional states joined the sales tax ranks;[28] one more was added in 1936,[29] and two more in 1937.[30] Since then, no other states have imposed this type of tax. Meanwhile, Louisiana repealed its sales tax law,[31] but a similar tax has been put into effect in

[23] *Id.* at 232.
[24] JACOBY, *op. cit. supra* note 18, at 87.
[25] *Ibid.*
[26] *Ibid.*
[27] *Id.* at 73.
[28] *Id.* at 87.
[29] *Ibid.*
[30] *Ibid.*
[31] La. Acts 1940, act No. 82.

New Orleans, the largest city of the state.[32] Although sales tax laws are thus today in force in less than half the states, more than half the nation's population pay general sales taxes imposed under authority of the states or their political subdivisions.[33]

Revenue productivity of state sales taxes is shown in the following table:

TABLE II

PER CAPITA YIELD OF STATE SALES TAXES IN 1940

State	Rate	Kind of Tax	*Yield	†Population	Yield Per Capita
California	3%	Retail Sales and Use	$98,063,000	6,874,000	$14.27
Washington	2% .25 of 1%[a]	Retail Sales and Use Occupation	20,689,000	1,721,000	12.02
Illinois	3%	Retail Sales	90,818,000	7,874,000	11.54
Michigan	3%	Retail Sales and Use	60,374,000	5,245,000	11.51
West Virginia[b]	2% --[c]	Retail Sales Gross Income	20,630,000	1,900,000	10.86
Wyoming	2%	Retail Sales and Use	1,994,000	247,000	8.07
Arizona	2%[d]	Occupation	4,010,000	498,000	8.05
New Mexico	2%	Occupation	4,198,000	529,000	7.94
Colorado[b]	2%	Retail Sales, Use and Services	8,484,000	1,119,000	7.58
Utah	2%	Retail Sales and Use (Some Service)	4,199,000	548,000	7.66
South Dakota	3%	Retail Sales and Use (Some Service)	4,504,000	641,000	7.03
Indiana	1%	Gross Income	23,538,000	3,416,000	6.89
Ohio	3%	Retail Sales and Use	46,105,000	6,890,000	6.69
Iowa	2%	Retail Sales and Use (Some Service)	16,858,000	2,535,000	6.65
Missouri[e]	2%	Retail Sales (Some Service)	22,332,000	3,776,000	5.91
Kansas	2%	Retail Sales (Some Service)	10,080,000	1,799,000	5.60
North Dakota	2%	Retail Sales and Use	3,099,000	640,000	4.84
Oklahoma	2%	Retail Sales and Use (Some Service)	10,952,000	2,330,000	4.70
North Carolina	3% .05%	Retail Sales and Use Wholesale	12,208,000	3,563,000	3.43
Mississippi	2%	Occupation and Use	6,743,000	2,182,000	3.09
Arkansas	2%	Retail Sales and Use (Some Service)	5,514,000	1,948,000	2.83
Alabama[f]	2%	Retail Sales and Use (Inc. Amusement)	5,890,000	2,830,000	2.08
Louisiana[g]	1%	Retail Sales and Use	5,981,000	2,356,000	2.54

*United States Department of Commerce, Bureau of the Census, State Tax Collections (1940) Preliminary Report, 8.
†Preliminary Census Release, 1940.
[a] Other rates .001 - ½ of 1%.
[b] Yield for fiscal year ended 6-30-39.
[c] Rates vary .15% to 6%.
[d] Rate is for retail sales.
[e] Yield for fiscal year ended 12-31-39.
[f] Yield for fiscal year ended 9-30-39.
[g] Repealed July, 1940, effective December 31, 1940. La. Acts 1940, act No. 82.

A wide range of revenue productivity is indicated by the foregoing table. California leads the field, both in total sales tax collections and in per capita yield. Three other states, with comparable population and business activity, all impose taxes at the same rate, namely, three per cent, but the productivity of these taxes has been substantially less. One of these states—Illinois—has an annual *per capita* yield of $11.54 in contrast with California's $14.27, but if adjustments were made because of taxes imposed

[32] City of New Orleans Ordinance No. 15,201, approved December 12, 1940. C. C. H., INTERSTATE SALES TAX SERV. ¶5661 *et seq.*

[33] (1941) 26 BULL. NAT. TAX ASS'N 226.

in Illinois with respect to transactions exempt in California[34] the *per capita* yield in California would be increased to $18.34, representing approximately fifty per cent more revenue than is derived in Illinois. The remaining comparable states, Michigan and Ohio, have tax bases more nearly like that in California, although there are significant variations in each.[35] Yet, the *per capita* yields indicate substantially less revenue than in California. While some of this difference may be attributable to the greater buying power of California's population, it is believed that the most important factor involved in the high productivity of the California sales tax is the thorough organization of its field audit program.

Speaking on this point at the National Tax Conference in 1937, A. J. Maxwell, North Carolina Commissioner of Revenue, addressed his remarks to[36]

> . . . certain phases of sales tax administration which I believe demand the attention of all of us engaged in that work. In the first place, I desire to stress the importance of an adequate field audit program. In the second place, I want to emphasize the necessity of prompt action in determining additional taxpayers' liability and to point out the inevitable embarrassment which arises from long deferred demands for payments in addition to those which are made by the taxpayer at the time of filing his returns.
>
> When I was in California recently, I had an opportunity to observe what was being done there with respect to field audits and to talk to the men who are in charge of that work. I found that it has been their constant aim to make determinations of additional taxes as soon as possible and to effect these collections promptly. . . .
>
> I want to repeat that, to my mind, a sales tax administration is only as good as its auditing program. A staff of good auditors, intelligently directed in a courteous but firm attitude toward the retailers paying the tax, is essential to successful sales tax administration.

This vigorous summation of the situation impels the conclusion that it is folly for any state imposing sales taxes to attempt to save money by curtailing administrative expense to a point where field audits cannot promptly be made. The nature of sales tax administration is such that it requires constant vigilance if the results are to be satisfactory. Cheap sales tax enforcement will prove, without doubt, the most expensive in the final analysis.[37]

Effectively administered, a general retail sales tax can be made one of the most productive and reliable sources of state income. This has been demonstrated in California where between August 1, 1933, the date when the California act first became effective, and December 31, 1940, revenues from this source totalled $598,-

[34] *Ibid.*

[35] The Michigan General Sales Tax Act excludes from the meaning of the term "sale at retail" transfers of tangible personal property ". . . for consumption or use in industrial processing or agricultural producing . . ." MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b). The Ohio Retail Sales Tax Act provides that "retail sale" does not include sales in which the purpose of the purchaser is ". . . to use or consume the thing transferred directly in the production of tangible personal property for sale by manufacturing, processing, refining, mining, production of crude oil and natural gas, farming, horticulture or floriculture, or directly in making retail sales . . ." OHIO GEN. CODE (Page, 1937) §5546-1. While no such exclusions are found in the California act, these are offset by exemptions of more or less comparable fiscal effect, not found in the Michigan and Ohio acts.

[36] Maxwell, *Discussion* (1937) 30 PROC. NAT. TAX ASS'N 47, 48.

[37] See, further, the emphasis placed upon this by Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes, infra* this issue.

134,588. For the last completed fiscal year, namely, that ended June 30, 1940, sales and use tax collections represented 37.86 per cent of the California tax dollar. This was the largest single item of state revenue. The next largest item was motor vehicle fuel taxes which represented 19.75 per cent of the tax dollar. Although not the next largest item, excise taxes on alcoholic beverages were among the substantial contributors to the state's tax dollar, accounting for 4.22 per cent of its revenue. Thus, these three consumers' excises produced in excess of three-fifths of the total revenue of the State of California for the last fiscal year.[38]

This trend may be somewhat accentuated in California, but it is not peculiar to that state. Data gathered by the Bureau of the Census of the United States Department of Commerce disclose that sales taxes of various kinds account for 39.5 per cent of the state tax dollar throughout the country.[39] Not only are sales taxes the largest contributors to state revenue, but they accounted for the major part of the increase in state tax collections for 1940 which reached a total of $4,171,000,000, marking a gain of more than 7 per cent over the corresponding figure for 1939.[40] Commenting upon the part of sales taxes in this gain, the Bureau of the Census has this to say:[41]

> Overshadowing in absolute volume all other increases in tax yields was a $50 million rise in general sales tax collections, an increase of 11.4 per cent. Collections of sales taxes on tobacco showed the largest percentage increase—63.2 per cent—amounting in absolute figures to nearly $38 million. . . .
>
> The rapid increase in collections of sales taxes of all kinds in the past two decades has been one of the most significant and quantitatively greatest revolutions which has ever taken place in the American tax system. By 1937 sales taxation . . . had practically assumed the place, in State tax systems, that was occupied by general property taxation prior to 1919.
>
> Conforming to this trend, general sales taxes, which were non-existent in 1919, yielded gross collections of $486 million, or 11 per cent of all State tax collections, in 1940. . . .
>
> Reflecting the increased importance of sales taxes is a related increase in collections from gross receipts taxes on various specified businesses. . . . It is not possible to separate all gross receipts taxes over a period of years from other taxes levied on similar businesses. . . . It is significant to note, however, that the economic incidence of gross receipts taxation is probably the same as that of a sales tax, when levied on the same business. Therefore, in considering the question of incidence of State taxes, or the economic results of the system of taxation now becoming predominant in American State governments, it is necessary to include gross receipts taxes together with sales taxes in the calculations.

Accordingly, the Census Bureau indicates that approximately $110,000,000 of the 1940 state collections derived from taxes on specific businesses and occupations, consisted of taxes measured by gross receipts which should be added to the $486,000,000 of sales tax revenue, making a total of approximately $600,000,000 realized by the states from consumers' excises of various types.[42] These figures express with con-

[38] (Jan., Feb., March, 1941) 3 ASSESSOR'S NEWS LETTER (California State Board of Equalization) (No. 1) 4.

[39] Department of Commerce, Bureau of the Census, *State and Local Government* (1941) Special Study, No. 10, at 2.

[40] *Id.* at 1. [41] *Id.* at 2. [42] *Id.* at 4, 7.

vincing eloquence the revenue productivity of taxes of this type as imposed today in the American states.

What, then, of the desirability of such taxes as respects their satisfaction of the requisites of equity? Are they so regressive that their use should be avoided or at least curtailed in order to avert undesirable consequences? What was said in the course of a discussion of this subject at the Thirtieth Annual National Tax Conference in Baltimore, Maryland, four years ago throws so much light on the changing economic thought that a review of the discussion should prove illuminating.

Speaking on the implications of federal financial policies, Professor Herbert D. Simpson, of Northwestern University, made these observations:[43]

> . . . the federal government has largely absorbed any potential areas of increased revenues for the states in three fields, namely: income taxation, estate and inheritance taxes, and corporation taxes, particularly through the undistributed profits tax. The one area of income taxation which many of us had hoped might afford a kind of reserve for state government needs was the area of so-called middle brackets, where the curve of federal rates has always thus far left a relative depression. But according to conversations and reports coming from the treasury department, it appears to be the intention of the department to exploit this remaining area in the next revision of the income tax. . . .
>
> This would seem to imply that the states are going to have to lean more heavily than ever upon the one substantial field of revenue still left to them, namely, the sales tax. Most economists have looked upon the general sales tax as an undesirable importation from European and Oriental countries—a tax that is not based on ability, benefit, or on any other accepted principle of equity in the distribution of public burdens. Its one merit is its capacity to produce enormous revenues, regardless of the condition of the taxpayers who pay it. As such, it affords a valuable source of revenue in times of emergency, and throughout the recent depression it has served this emergency purpose admirably. Many of us had hoped that with the passing of the emergency, it might be possible to look forward to a gradual relinquishment of this form of taxation. Any such hopes have been greatly diminished by federal policies of the past few years.
>
> In the field of municipal and local government, most students have recognized the enormous concentration of taxes upon real estate. Professor Fairchild made some pungent comments on that subject last year, with which I am fully in agreement. . . .[44] Property is an index of ability, a legitimate basis for taxation, and one that has demonstrated a high degree of merit.
>
> But nevertheless, most tax students have deplored the pyramiding of public burdens upon this one category of taxable capacity, not only from the standpoint of fairness to property owners, but from the standpoint of the financial stability of local governments. Most of us had hoped for some gradual lessening of property taxes through the transfer of a portion of the burden to income and other forms of taxation.
>
> Four years ago, . . . I presented figures showing that, on the basis of existing taxes and assuming a return to a level of prosperity equivalent to that of 1926, it would be entirely possible . . . to shift approximately one-third of total property taxes to income taxation, without hardship to anyone. I prepared a chart—a beautiful chart—of taxes and income, illustrating this possibility. That chart still hangs on the walls of my study, but it hangs like the harp that hung "on Tara's walls," after its soul was dead. The soul of my chart is dead, because, after the developments of the past four years, there is now no possibility

[43] Simpson, *Some Implications of Federal Financial Policies* (1937) 30 PROC. NAT. TAX ASS'N 137, 138.
[44] Fairchild, *The Impact of Federal Taxation on State Finances* (1936) 29 *id.* 283.

of shifting one-third of the burden of property taxes to income taxation—or to any other form of taxation that is now discernible.

Commenting upon what had been said by Professor Simpson, Professor Fred R. Fairchild of Yale expressed gratification concerning their agreement as to the significance of developments, saying that they were in agreement as to the predominant place of the property tax in American state and local finance, and continued that he noted with very great interest Professor Simpson's reference to the sales tax "as about the only available source of large additional revenues open to the state and local governments."[45]

Expressing further gratification, Professor Fairchild continued:[46]

I was pleased to notice that Professor Simpson suggests that the sales tax deserves a little more charitable treatment than it generally gets, at least in popular discussion, and perhaps I am inclined to be even a bit more charitable than he was. I would be disposed to challenge the common assumption that the sales tax bears no relation to tax-paying ability. . . . The amount of the tax bears some relation to tax-paying ability. It does not bear the perfect relation. It does not permit of the progressive relation such as the income tax allows. It does not, perhaps, even place a burden in proportion to the total income or tax-paying ability of the taxpayer, but conceding all of that, we must not make the rather crude error of saying that the sales tax has no relation whatever to ability, when it is well known that some people pay five, ten, twenty, or a hundred times as much under a given sales tax than do others.

The sales tax, then, I say, does have some relation to ability, and it is a tax which in combination with other taxes, some of them progressive, may permit the building up of a general tax system providing whatever relation to tax-paying ability may be desired.

I am also disposed to refer to those of whom Professor Simpson reminds us, who regard the sales tax as an outlandish importation from European and Oriental countries. Let us not forget that broadly defined as taxation of consumption, such taxes have a long and fairly respectable record in the United States.

Following these observations, Harley L. Lutz, professor of Public Finance at Princeton University, joined his fellow economists in the discussion with this pungent comment:[47]

I was particularly interested to have both Professor Fairchild and Professor Simpson begin to take down their back hair, so to speak, with respect to the subject of ability. I have been coming more and more myself to the conclusion that it is about time that someone who was thoroughly competent should reexamine the concept of ability, first, because of some possible question regarding its necessary theoretical function, and secondly, because of the extent to which ability has been overworked. It has been so sadly misused in so many connections that I think it is time we had a clearer and fresher statement of it.

I think in that connection there is a tendency to overemphasize Adam Smith's first canon, and to neglect somewhat the bearing of the other canons of taxation suggested by Adam Smith upon the first one, not with any hope that we can ever get a perfect tax that will ideally carry out the full implications of the four principles together, but with a view to discovering if possible the extent to which the original or the first one might be modified in certain respects by taking into account some of the others.

Let me illustrate. As both speakers . . . pointed out, ability has a certain standardized meaning and we immediately pass judgment on any tax by saying that it doesn't conform

[45] Fairchild, *Discussion* (1937) 30 *id.* 145.
[46] *Id.* at 145-146.
[47] Lutz, *Discussion* (1937) 30 *id.* 155-156.

to ability, meaning, if the small income fellow pays a certain amount of tax and the man with a large income pays the same amount of tax, it is regressive with respect to the smaller income—it is a larger percentage of the small income than it is of the large income.

We assume that that is all there is in the question of ability to pay, and so we have fallen into the habit of condemning certain taxes, conspicuously the sales tax, because we say right off-hand it violates this fundamental principle of ability to pay, it is regressive.

But that isn't all there is to it. Adam Smith said in another one of his famous maxims on taxation, "the tax shall be collected in the manner and at the time most convenient for the taxpayer to pay it." In a practical sense, not in an abstract theoretical and, I might say, mathematical sense, but in a practical sense, I think that has a good deal to be said for it.

Pointing out that instalment tax payments had gained in favor during recent years, Professor Lutz mentioned the fact that the federal law permits payment of income taxes in four instalments; that a few states permit comparable payments in the same number of instalments and that some of them provide for two instalments; that in several states the property tax may now be paid in instalments, it being possible in some of them to divide the tax due into as many as four payments. Continuing this thought, he observed:[48]

You are never required to plank down any large amount in cash on account of the gasoline that you buy. You can pay it in driblets. None of the sales tax states requires you to fork over a large sum on the first of the month on account of the groceries or the coal or any other commodities that you have bought subject to the sales tax during the month. They apply perfectly the canon of convenience. They are collected at the time and in the manner most convenient for the taxpayer to pay them. Furthermore, I should like to point out that they conform admirably to the other principle that Adam Smith suggested, namely, that the amount of the tax should be certain and not arbitrary. . . .

Few people are ever in any doubt as to the amount of sales tax they are paying. There is never any question of going back over the amount of groceries in the year before last bill and assessing a deficiency tax against them. So far as the certainty of the tax and the convenience of the tax are both concerned, I suggest that many of the indirect taxes stand up very well.

So if we ever get around to that state of mind in which we are willing to think of this question of ability to pay as involving not simply a kind of "bastard" mathematics, because that is what it is in reality, a kind of "bastard" mathematics by which we have concluded that certain taxes are regressive and therefore undesirable, and look at the thing from a more realistic, a more practical, a more common-sense point of view, we may find that we have been on the wrong track in considerable degree in the past with respect to our construction and application of the ability principle.

Cautioning that he was not to be understood as suggesting that we should immediately scrap the income tax or inheritance taxes, Professor Lutz said that he meant merely to imply that economists should liberalize their judgments with respect to the quality of some of the other taxes, such as consumers' excises. He reminded the conference how "exceedingly flimsy a reed you have in the kind of income tax that we use, because it is essentially a prosperity tax." Continuing in this vein, he observed that:[49]

It isn't worth a "hoot" in a depression, and if it hadn't been for the indirect taxes that the federal government used and the indirect taxes the state governments used, I hesitate

[48] *Id.* at 156, 157.

[49] *Id.* at 157.

to try to picture to you the kind of financial chaos in which the federal or state governments would be likely to be.

A little later at the same session of the conference, another speaker[50] expressed the view that the convenience of collection is what is wrong with some of our sales taxes, resulting in a failure on the part of the public at large to recognize the extent of the tax load. Answering this suggestion, Professor Lutz made this comment:[51]

I think we overestimate the ignorance and indifference of consumers when we imply that they do not know what it is all about. I am inclined to say that we ought to, on the other hand, give them credit for enough intelligence to appreciate the merit of that method of collection and to be willing to pay a somewhat larger tax in that way than to have to submit to the inconvenience—in many cases it would be a serious inconvenience—of forking over a smaller total sum in one lump payment.

Adam Smith said, "There is a certain price which men are willing to pay in order to be free from the odious oppression of the tax-gatherer." I believe that a great many people are willing to pay a somewhat higher price for their share of the cost of government and do it in a way that frees them from the inquisitorial methods and the odious oppression of the tax-gatherer to which they are inevitably subject when the tax is based upon net income and is collected in the manner that has become so popular for the administration of that task.

As indicative of the circumstance that the views expressed by Professor Fairchild and Professor Lutz are not wholly shared by other economists, Professor J. H. Hollander of Johns Hopkins fired this parting shot at the conclusion of the conference:[52]

. . . I feel that loyalty to my faith compels a caveat against the views so clearly set forth by Professor Fairchild and Professor Lutz. It seems to me, with reference to the doctrine of ability, a clear distinction must be drawn between what is the principle, what is the ideal to which a tax system should conform, and a rationalization of the tax practices which obtain. . . .

We now face a situation where the economist may either continue crying like a voice in the wilderness or turn and say, "Well, after all, we have, and we are, drifting toward the sales tax and the indirect tax. Perhaps there is something more in it. Perhaps we have been worshipping false idols. Let us see whether after all this to which states have drifted isn't a safer procedure theoretically, a safer principle theoretically, than we had supposed."

Contribution to the state in the form of successive installments is the familiar device of the sugar-coated pill, of the greater ease, and it is in violation of that which I cannot but regard as a fundamental principle of the relation of the citizen to the expenses of government, contribution according to his economic capacity.

A point to be stressed in connection with these arguments as to the equity and desirability of the sales tax is the fact that the functions of government have changed substantially since the traditional views were first formed with regard to the requirements of sound taxation. New conceptions as to what government shall do for the people require new conceptions as to what the people shall do to sustain the government. Increasing governmental activity and widespread extension of governmental benefits necessitate re-examination of economic concepts formed during periods when governmental services were not so universally enjoyed. Broadness of base, universality

[50] Seidman, *Discussion* (1937) 30 *id.* 159, 160.
[51] Lutz, *Discussion* (1937) 30 *id.* 160-161.
[52] Hollander, *Discussion* (1937) 30 *id.* 162.

of impact, ease of collection, distribution of payments in small amounts throughout the year are attributes of a tax law not to be disregarded under current conditions in the American states. If these states should rely wholly or mainly upon consumers' excises, much of the criticism that economists have directed toward such taxes might well apply. On the other hand, if, as in California, state taxes on personal and corporate incomes contribute more than 17 per cent of the tax dollar and are supplemented by inheritance and gift taxes, accountable for 4.12 per cent of that dollar,[53] it would appear that there has not been any substantial neglect of progressive taxes at the expense of consumers taxed indirectly on an excise basis. Moreover, it must be borne in mind that property taxes are still the backbone of the revenues of the political subdivisions in the state and have an annual yield more than three times greater than that of the sales tax.[54] Consequently, it would seem reasonable to assume that no substantial violence is done to sound economic practice when the sales tax imposed in an American state is only a part of a revenue structure balanced by substantial income, inheritance, and property taxes.

It must also be borne in mind that, while for reasons already suggested[55] the Federal Government does not impose direct property taxes, it does impose substantial levies on incomes, both personal and corporate, and on estates and gifts, so that these fields of taxation are, as Professor Simpson pointed out at the Baltimore Tax Conference in 1937,[56] fairly well pre-empted by the national government. In fact, since the recent national emergency, the force of his remarks is much greater than it was when they were uttered four years ago. Thus, while the case for the retention of the sales tax on economic grounds may not be as strong as the most ardent advocates of this form of taxation would like to have us believe, the case against the tax is by no means compelling. The necessity for the revenue which it produces is inescapable and it seems clear that the current need for the retention of the tax is such as to eliminate the possibility of its abandonment unless it shall be shown to be so expensive to administer or so adverse in its effect on business as to defeat the purpose for which it is imposed, namely, the effective production of public revenues.

In California, where gross income from the sales tax has been outstanding, administrative costs have not been disproportionately high. Currently, these costs represent approximately 2.52 per cent of the total collections.[57] It has been demonstrated that for every dollar spent on field audits approximately $4.50 can be returned in additional revenues. The net result of this has been that the field audit program has of itself produced more than enough to pay the entire costs of administration. Experience in other states has indicated that there is considerable variation in administrative costs which range from less than one per cent to over four per cent.[58] In none of the other states, however, has the *per capita* yield approached that in California so that it may be concluded that in order to enforce the tax efficiently a reasonable, but not excessive, administrative expense is required. Owing to favorable economic

[53] ASSESSOR'S NEWS LETTER, *supra* note 38.
[54] *Id.* at 6.
[55] See discussion at p. 431, *supra*.
[56] Simpson, *supra* note 43.
[57] Cal. State Board of Equalization, *Biennial Rep.* (1939-1940) 4.
[58] Fed. Tax Adm'rs, *Research Memorandum No. 72* (Nov. 1938); Huston and Berryman, *supra* note 37.

and geographical conditions, California authorities may have a somewhat easier task than that confronting sales tax administrators elsewhere, but it seems fair to assume that in the average state an efficient sales tax administration should be achieved at an administrative cost not materially exceeding three per cent of the total collections. If this is correct, it would follow that the expense is not disproportionately high, inasmuch as experience with respect to income and property taxes generally has indicated that effective administration cannot be achieved at costs which are relatively lower. In fact, it has been demonstrated that efficient administration of these other taxes frequently requires expenditures absorbing considerably higher percentages of the total collections. Thus, the efficiency of the sales tax as a revenue producer is not vulnerable to attack on the ground that this form of taxation requires an excessive administrative outlay.

Much has been said with respect to the incidence of retail sales taxes and their effect on business. The principal difficulty in connection with these utterances is that they have for the most part been self-serving declarations of those who were either desirous of demonstrating that the tax is ideal or, contrariwise, that it is iniquitous. As pointed out in a recent article by John F. Due of the University of Utah,[59]

> The explanation of the incidence[60] of retail sales taxation has failed to keep pace with the expansion in the use of the levy in the United States. The general belief is that such taxes are borne by the consumer group except under unusual conditions.[61] This view has been accepted by legislative bodies; attempts have been made in some states to insure that shifting will occur by special provisions of the law. However, little careful analysis of the problem is to be found. Neither in terms of the theory of value or retail pricing practices[62] has shifting been explained in any detailed fashion. The empirical studies of Haig and Shoup and others are of limited scope and of questionable significance in regard to long run incidence.

Commenting upon the immediate effect of sales taxation on retail prices, Mr. Due continues:[63]

> When a general retail sales tax is introduced, the costs of handling each good are increased by the amount of the tax. Accordingly, firms will attempt to increase the percentage markup; since the tax takes a uniform percentage of the sale price of the goods, the percentage increase in markup will be the same so far as margins are uniform among lines; where they are not, the percentage increase in markup will be greater in the cases in which the margin is smaller. . . . In some cases, the stores may add the tax as a separate charge, quoted separately from the original price; in this case there are essentially two margins, one collected by the retailer for himself, the other for the state.

As to the ultimate effect of the tax on retail prices, Mr. Due has this to say:[64]

[59] Due, *The Incidence of Retail Sales Taxes* (1940) 25 BULL. NAT. TAX ASS'N 226.

[60] By the term incidence is meant the manner in which the burden of the tax is finally allocated as among various groups in the economy. This can be determined only after consideration of all readjustments which occur as a result of the tax, including such secondary reactions as changes in the prices of the factors. (Author's footnote).

[61] That is, that consumers are able to obtain less goods and services from their money incomes because of price increases. (Author's footnote).

[62] The best discussion on this basis is that by Willemsen, A. C., "Operating Aspects of the Retail Sales Tax," Harvard Business Review, II: 107-114, Oct. 1932. (Author's footnote).

[63] Due, *supra* note 59.

[64] *Id.* at 227.

In general, the long run incidence of the tax is the same as that immediately after the imposition of the levy, so long as costs, exclusive of the tax, are not affected by the latter. The average cost at the reduced volume of output may be somewhat less in the long run than at the time of the original levying as capacity is readjusted; the additional burden on the consumer may thus be reduced somewhat over a period of time. . . . Once the increase, which allows full shifting, occurs, there is no reason for a subsequent price decline, so long as factor prices remain unchanged.

The point may well be raised as to the significance of certain state laws requiring the addition of the tax as a separate charge apart from the sale price of the goods. Under pure competition, such laws are entirely futile, since no firm can raise its prices at all until exodus; with pure monopoly they would not accomplish their purpose since the monopolist would typically reduce his net sale price. But with monopolistic competition and oligopoly,[65] the provisions are of considerable importance in aiding price increase, since each firm is given added assurance—though of course no absolute guarantee—that the other firms will raise their prices. A powerful psychological force is added to the elements facilitating shifting. No longer does the force of inertia—of letting existing conditions remain—favor absorption, but instead serves to aid shifting.[66]

Developments in the interpretation of the commerce clause of the Federal Constitution, by which use and sales taxes on incoming interstate shipments have been approved,[67] have done much to mitigate the trade-area difficulties to which the Chairman of the Mississippi Tax Commission alluded in 1933 when he spoke of some of the objections made to sales taxes by the mercantile interests.[68] Consequently, it would seem that while such taxes inevitably must affect the volume of trade to some degree just as would any factor increasing the cost of doing business, they do not appear to constitute positive hazards to profitable commercial enterprise under normal conditions. On the other hand, because of the crucial fiscal needs of the states, inclusion of such taxes as a part of their revenue systems would seem preferable to increases in income taxes, either corporate or individual, or property taxes as to which the burden is so heavy that added use of these levies would produce greater hardship to business than would the retention of moderate sales tax rates.

To attempt to forecast the developments in respect of the place of consumers' excises in the tax system, would be rash indeed. Perhaps the best observation would be one made several years ago by that eminent economist, Professor Adams, whose words were quoted at the beginning of the consideration of this topic. To again borrow from Professor Adams,[69]

Taxes are as complex as life. The moralist calls for just taxes; but taxes cannot just be *just*. The administrator asks for simple taxes; but experience shows that they cannot simply be *simple*.

[65] That is, that firms take into consideration the effect of their own policy on that of their competitors. (Author's footnote).

[66] Consumption-tax shifting is analyzed by Martin, *Distribution of the Consumption Tax Load*, *infra* this issue.

[67] Henneford v. Silas Mason Co., 300 U. S. 577 (1937); Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939); Felt & Tarrant Mfg. Co. v. Gallagher, 306 U. S. 62 (1939); McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33 (1940); Nelson v. Sears, Roebuck & Co., 312 U. S. 359 (1941). These developments are traced and evaluated by McNamara, *Jurisdictional and Interstate Commerce Problems in the Imposition of Excises on Sales;* Brown, *The Future of Use Taxes*, both *infra* this issue.

[68] See the quotation at p. 433, *supra*.

[69] Quoted by Stone, Chairman, Mississippi Tax Commission, *supra* note 20, at 230.

DISTRIBUTION OF THE CONSUMPTION TAX LOAD

James W. Martin*

I

Tax students who have studied the distribution of the consumption tax load attack it theoretically from the angle of its effect on prices. The problem, thus, becomes one of incidence in the narrower economic sense of the word.[1] Studied from this point of view, the variables which must be analyzed differ depending on the approach adopted. One stimulating and significant study[2] places primary emphasis on whether the taxpayer subject to a commodity tax is a competitive or a monopolistic producer. In each instance these writers examine the problem according to the form of tax imposed—whether a specific, *ad valorem*, gross receipts, lump sum, or net return levy. An earlier student has suggested that the problem may be formulated in terms of whether transactions involved are all competitive, whether sellers produce at increasing costs, whether capital and labor employed in production are mobile or otherwise, and whether taxes are on the margin or on surplus.[3] Still another writer has recently couched his inquiry primarily in terms of cost conditions among taxpayers.[4] Some or all of these, together with other writers, also stress, among other factors, the question as to whether the taxes imposed apply to all or only a part of the competitive businesses, whether the rates are graduated,[5] and how the proceeds of the taxes are actually expended.[6]

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The author's colleague, Mr. Glenn D. Morrow, has aided greatly in the preparation of this paper.

[1] See, *e.g.*, Kendrick, *Incidence and Effects of Taxation* (1937) 27 Am. Econ. Rev. 725.

[2] Fagan and Jastram, *Tax Shifting in the Short Run* (1939) 53 Q. J. Econ. 562. See also *Discussion* (1940) 54 *id.* 665.

[3] Edgeworth, *Pure Theory of Taxation* (Mar. 1897) 7 Econ. J. 46, reprinted as first half of *The Pure Theory of Taxation*, in 2 Edgeworth, Papers Relating to Political Economy (1925) 63.

[4] Gilbert, *Shifting of Sales Taxes* (1939) 53 Q. J. Econ. 275.

[5] Since most sales taxes are imposed at flat rates, this inquiry is largely irrelevant to the present immediate problem.

[6] In the last connection attention should be directed particularly to the stimulating discussion by Kendrick, *Public Expenditure: A Neglected Consideration in Tax Incidence Theory* (1930) 20 Am. Econ. Rev. 226, despite the fact that Kendrick, in common with Buehler, *Public Expenditure and the Incidence of Taxes: Some Theoretical Considerations* (1938) 28 Am. Econ. Rev. 674, appears to have neglected

For purposes of this article, analysis in terms of individual taxes is likely to be more enlightening than analysis in terms of the more general and largely abstract studies which have been cited. As a type problem, consider general sales taxation. Although many writers have assumed that general sales taxes are shifted in their entirety to consumers, other students have seriously questioned this assumption.[7] The several careful studies which have been made[8] show (1) that shifting is incomplete, at least in the immediate months following enactment; (2) that the proportion shifted varies with legal provisions and with administrative methods employed and depends heavily on the extent to which the particular sellers are subject to competition from outside the state; and (3) that, as might readily be assumed on the basis of theoretical considerations, heavier rates facilitate more complete shifting than do lower ones. In general, the conclusion that the retail sales tax is in the long run well-nigh completely shifted seems to be defensible except as disturbances are introduced by outside competition or by other exceptional factors.[9] It might be well to note in this connection that the experience of Washington, Indiana, Mississippi, New Mexico, and West Virginia[10] seems to indicate that general retail sales taxes are more completely shifted, as well as more adequately administered, when levied in conjunction with taxation of services and a more general system of sales taxation involving, in addition to retail sales, sales of wholesalers and manufacturers.

Statistical breakdowns have been developed in the various states to show the distribution of retail sales taxes among different classes of merchants.[11] These disclose, for example, that the exact percentage of the total sales tax derived from sale of food products ranges from about 22 to less than 28 per cent of the total, depending heavily on the various other classes of commodities subject to the tax. There is considerable variation with respect to the proportion of the total supplied by public utilities, since one or two states do not include them within the purview of their taxes and certain others include only particular classes of public service enterprises. Moreover, the place in the total occupied by any particular class of business depends on the extent to which the state statistics completely classify all types of commodity groups.

Another approach is exemplified by the breakdown on a county basis to show

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significant earlier writers. Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes*, *infra* this issue, present valuable data on this question.

[7] *Cf.* in this connection Riley, *State Sales Taxes and the Cost of Food* (1937) 44 MONTHLY LABOR REV. 241.

[8] Bell, Guyton and Sackett, *Mississippi's General Sales Tax: How It Works* (1933) UNIV. OF MISS. BULL., Ser. 30, No. 3; HAIG AND SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934); JACOBY, THE RETAIL SALES TAX (1938).

[9] An interesting theoretical analysis which reaches a kindred conclusion is Brown, *The Incidence of a General Output or a General Sales Tax: Will It Raise Prices?* (1939) 47 J. POL. ECON. 254.

[10] For incidental evidence along this line see Halaas, *The Sales Tax in State Systems With Particular Reference to Its Operation in Colorado* (1937) 13 UNIV. OF DENVER REP. No. 3.

[11] *Ibid.*; Ford and Orkin, *The Retail Sales Tax in Michigan* (1936) UNIV. OF MICH. (Bur. of Gov.) N. S. BULL. No. 6; Kansas Legislative Council, *The Kansas Retail Sales Tax Fund* (1938) PUB. No. 65; *cf.* Colm and Tarasov, *Who Pays the Taxes?* (1940) T. N. E. C. MONOGRAPH No. 3, at 22.

the extent to which farm, urban, mining, and other counties contribute to the total. Studies of this sort have been made for Michigan,[12] and for Colorado and Wyoming.[13] They seem to indicate that in the distribution of the tax load poorer farm territory has suffered in comparison with the urban communities and with the better farm territories. In Michigan, mining counties appear not to have fared as well as certain others.

The most significant, at least the most persistently used, analyses of the distribution of the general sales tax load among different income groups have rested on an investigation by *Business Week*.[14] This report of American consumer expenditure budgets by income groups formed the basis of a pioneer sales tax incidence study by Dr. Mabel Walker,[15] who undertook to show the percentage of net income required to pay a retail sales tax (on the assumption that the tax is shifted to consumers). Her study, quoted by numerous writers since, revealed the rate and the extent of regression in respect of food, housing, transportation, personal items, clothing, recreation, health, education, and civic expenses. More recent tax understanding adds to knowledge concerning incidence. One commentator, concluding an examination of sales taxation as a source of relief funds,[16] has pointed out that use of the general sales tax to finance unemployment relief produces an anomaly in that the tax falls heavily on the unemployed and others whose income must be largely spent for taxable consumption. Collection methods also have their bearing. Thus the extent of regression under sales taxes depends, among other things, on whether consumers pay by brackets or utilize tokens. Regression is increased by the former policy; the administrative problem for the state, by the latter.[17]

Similar analyses have concerned selective sales taxes. With respect to beer and liquor excises, the assumption that the tax is incorporated in the price appears to be largely borne out by investigations,[18] but the data also show that taxes have materially influenced the volume of business done. Perhaps the most significant statistical investigation of this nature has been made by the Bureau of Agricultural Economics for the Treasury Department.[19] This study involves all the processing taxes and includes a tabulation revealing conclusions not only as to incidence but also as to immediate impact, effects on the processor's buying and selling prices, and the immediate consequences of repealing the taxes.

In addition to the studies of the incidence of particular consumption taxes, there has recently become available a significant report[20] showing the distribution of the

[12] Ford and Orkin, *supra* note 11, at 20.

[13] Halaas, *supra* note 10, at 9 *et seq.*

[14] *The Americans' Consumer Market: A Study by the Business Week* (Sept. 7, 1932) BUS. WEEK, 16.

[15] *Where the Sales Tax Falls* (General Welfare Tax League, 1934), also reprinted in BLOOMFIELD, SALES TAXES: GENERAL AND RETAIL (1934) 177.

[16] Ecker-R, *The Sales Tax As a Source of Relief Revenue* (F. E. R. A. Div. Research, Statistics and Records, 1936).

[17] On collection and enforcement aspects of consumption taxation, see Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes*, *infra* this issue.

[18] Studenski, *The Liquor Tax Problem Ahead* (Jan. 24, 1941) J. COMMERCE 6.

[19] *An Analysis of the Effects of the Processing Taxes Levied under the Agricultural Adjustment Act* (U. S. Treas. Dept., 1937).

[20] Colm and Tarasov, *supra* note 11.

consumption taxes generally by income groups. It is apparent from the evidence, presented in Table I, that, although consumer taxes normally contribute to regression, the extent of inequality in the distribution of the total tax load, owing to the compensating influence of income and property taxes, is not great except as respects persons who earn definitely less than $1,000. That is, the higher aggregate rates on lower incomes are confined to the point at which the problem is most serious statistically and socially. There is evidence from comparison of this study with one made as of 1924[21] that the area of definite regression on small incomes has been cut, and the extent of it within the narrowed range has become much more intense by reason of heavier consumer imposts.

TABLE I

EFFECT OF THE AMERICAN TAX SYSTEM ON THE VARIOUS INCOME CLASSES, IN 1939[22]

	Percentage of income paid out in taxes		
Income classes	*Personal taxes*	*Taxes on consumption*	*Total*
Under $500	1.3	20.6	21.9
$500-$1,000	.9	17.1	18.0
$1,000-$1,500	1.0	16.2	17.2
$1,500-$2,000	1.5	16.4	17.9
$2,000-$3,000	1.5	15.9	17.4
$3,000-$5,000	3.4	14.2	17.6
$5,000-$10,000	6.6	11.4	18.0
$10,000-$15,000	16.6	9.0	25.6
$15,000-$20,000	23.9	7.7	31.6
$20,000 and over	32.5	5.2	37.7
Total	5.7	14.5	20.2

In considerable degree, the studies of incidence, whether in abstract or in statistical terms, fail to reach the entire problem. Generally, such studies assume static, and therefore non-existent, economic conditions. At least they ignore certain institutional factors and the entire temporal aspect of economic life. The general orthodox studies, moreover, couch their reasoning in terms difficult of practical application. For a legislator the problem of whether or not he should vigorously fight a sales tax on storage batteries produced in his district rests not on whether production occurs under conditions of increasing costs but rather on how the proposed tax will affect storage battery prices and sales volume. These considerations suggest, not that the usual approach is unsound or useless, but that the total impact of each consumer tax be fully investigated. The student needs to know as much as possible in both directions. For background policy decisions it is necessary to know, as nearly as possible, the incidence of each impost; but it is equally desirable to ascertain the over-all effects of the tax.[23]

[21] SHULTZ, WHO ULTIMATELY PAYS THE TAXES? (1924) 15.

[22] Adapted from Colm and Tarasov, *supra* note 11, at 13, Table Ib.

[23] Suggesting some approaches to over-all effects of consumers' taxes is the purpose of the second part of this article. Analysis of temporal considerations is deferred to a later paper pending further study.

II

Numerous varieties of statistical and other evidence are available respecting the larger consequences of sales taxes. Some of these effects are inclusive of incidence and some of them are exclusively secondary in the sense that they do not include price readjustments. One class of effects arises from sales taxes imposed for restrictive purposes. Most of these measures seek to divert consumption from one channel to another. Illustrations may be found in the case of tobacco, alcoholic beverage, and margarine taxation.[24]

To outline the possibilities of productive study along this general line, certain concrete examples are presented. In 1934 it was proposed that federal cigarette taxation be revised to approximate somewhat more closely an *ad valorem* basis without, however, abandoning the administrative advantages of the specific tax. In hearings before Congressional committees, much of the most significant testimony related to the discriminatory effects of the tax existing at that time or of the proposed tax, "depending on whose ox was gored."[25] The Treasury and the Bureau of Agricultural Economics, both of which conducted an extensive study of the problem, maintained that the flat $3.00 rate tended to shift cigarette tobacco consumption toward the more expensive grades of tobacco. In the view of these agencies, consumption of tobacco for cigarette purposes would probably be more nearly in proportion to the production of different grades, were there in effect the proposed thirty-cent tax reduction on cigarettes retailing for ten cents a pack. On the other hand, Mr. Junius Parker,[26] tobacco company counsel, suggested that such a measure would tend to interfere with the demand for superior tobacco and thereby wreck the price structure.

A second illustration of tax measures designed to influence consumption is found in the case of wine taxes. Although several states have enacted such measures,[27] perhaps the experience most discussed has been that of Michigan which, like Arkansas, Georgia, and New Mexico, provided a preferential tax rate if locally grown grapes were used in the manufacture of wine. As a consequence vineyards were so generously planted that the Michigan grape growers undoubtedly suffered more than any other persons from this legislation enacted in their behalf.[28] Probably citizens of the state adopting such discriminatory legislation almost invariably suffer from it more than anybody else.

Another similar effect brought about in the case of a beer statute designed to

[24] The use of consumers' taxes for regulatory ends is considered in Hart, *Consumption Taxation as an Instrument of Economic Control, infra* this issue.

[25] For a comparatively unbiased viewpoint see the testimony of Mr. Henry Morganthau, Secretary of the Treasury, A Statement on the Proposal to Reduce the Tax on Ten-Cent Cigarettes, *Hearing Before the Senate Committee on Finance*, 73d Cong., 2d Sess. (1934) 1; and for characteristic viewpoints respecting the two sides of the argument consider the statements of Mr. Wood F. Axton, *id.* at 5, and Mr. Junius Parker, *id.* at 13.

[26] *Id.* at 23.

[27] See *Comparative Charts of State Statutes Illustrating Barriers to Trade Between States* (W. P. A. Marketing Laws Survey, 1939) Chart 6, at 65 *et seq.*

[28] Melder, *State Trade Walls* (1939) PUB. AFFAIRS INF. PAMPHLET No. 37, at 22.

favor Indiana brewers[29] led to a complete embargo on Indiana beer in Michigan[30] and Missouri.[31]

Similar provisions have been enacted with respect to distilled spirits.

A third illustration, which is perhaps more pointed because the tax is specifically designed to secure a preference, is found in the case of federal and state margarine taxes. These measures, first enacted by the Federal Government, have subsequently been passed by approximately half of the states. They are invariably intended to favor some particular variety or varieties of fats. The rates range up to fifteen cents a pound.

Data regarding the general effect of such measures are scarce. The influence of the federal tax, however, can be suggested by information respecting the volume of sales immediately before and immediately following the enactment in 1902 of the tax of ten cents a pound on artificially colored margarine. The total volume of margarine sales in 1900 and 1901 averaged about 106,000,000 pounds. The total volume in 1903, the year after enactment, was 73,000,000 pounds, declining to 50,000,000 pounds in 1904.[32] A Department of Agriculture report[33] shows that the number of retail outlets handling margarine in the states having available statistics declined markedly after enactment of the taxes. The decrease averaged 52 per cent in states having a five-cent tax, 91 per cent in those having a ten-cent excise, and over 99 per cent in those collecting fifteen cents a pound. These drops occurred at a time when the margarine business was definitely increasing elsewhere. It appears from the evidence that no reduction in the number of licensees developed from specific requirements regarding the character of the margarine to be sold.[34]

A second variety of available evidence indicates that the amount of revenue collected from margarine excises varies inversely with the rate of the tax. The five-cent taxes raise considerable revenue; the ten-cent taxes raise some revenue but very much less; the fifteen-cent rates produce insignificant revenue.[35] Thus, the margarine tax constitutes another example of the effective use of the states' taxing power in behalf of an organized minority group to effect non-revenue purposes.[36]

With this tax, as in the case of most discriminatory revenue measures, retaliation has been quite the normal result; although reprisals from other states seem not to have been as numerous and as devastating as might reasonably have been antici-

[29] Townsend (Gov., Ind.), *A State and Interstate Cooperation*, in PROC. NAT. CONF. INTERSTATE TRADE BARRIERS (Council of State Governments, 1929) 83. See also IND. STAT. ANN. (Baldwin, 1934) c. 12.

[30] MICH. STAT. ANN. (Henderson, 1936) c. 175, §18.1011, as amended by Mich. Pub. Acts 1937, No. 281.

[31] Mo. STAT. ANN. (1938) c. 31, §§4525-H-2, 4525-H-4, 4525-H-5. This measure was repealed by Mo. Laws 1939, p. 821.

[32] Statistics from reports of the U. S. Bureau of Internal Revenue.

[33] Taylor, Burtis and Waugh, *Barriers to Internal Trade in Farm Products* (U. S. Dep't Agric., 1939) 24.

[34] *Ibid.*

[35] *Id.* at 20; TAX SYSTEMS OF THE WORLD (8th ed. 1940) 325, 354. It is of particular interest that the Wisconsin fifteen-cent tax produced only $283 of revenue in 1937, whereas in the same year the five-cent tax of the smaller state of Iowa produced $304,918.

[36] *Cf.* STOCKWELL, STUDIES IN CALIFORNIA STATE TAXATION, 1910-1935 (1939) 262; and consult symposium on *Governmental Marketing Barriers* (1941) 8 LAW & CONTEMP. PROB. 207 *et seq.*

pated.[37] The Department of Agriculture report enumerates vigorous efforts to arouse unofficial embargoes against states imposing margarine taxes and adoption of formal resolutions by the Tennessee Federation of Labor, by the Arkansas General Assembly, and particularly by interested trade groups.[38]

In three respects consumption taxes have significantly restrictive effects even though imposed solely for revenue purposes: (1) violation of customary price, (2) elasticity of demand, and (3) inadequate administration. The effect most frequently overlooked is that arising from interference with customary prices. For instance, a tax is shifted forward in its entirety, but the volume of business is severely cut. In other cases, sellers may find it more palatable to assume the tax, or part of it, than to incur the loss in sales volume which shifting entails. Chewing gum, ice cream, soft drink, and general sales taxes are illustrative of incidentally restrictive consumer taxes which materially affect the business taxed, and sometimes related businesses as well, by reason of their disruption of a customary price.[39]

Before enactment of the Kentucky chewing gum tax of 1936, the price of the commodity had become well established at one cent a chew or five cents a pack. Imposition of the tax brought about a condition whereby dealers had to absorb the one-cent-a-pack tax, raise the retail price to six cents, or evade their liability. All three practices were attempted. If the price was increased by one cent the tax was successfully shifted, but the volume of consumption dropped so materially that the market was substantially destroyed. If the tax was absorbed, the profit for the small retailer was eliminated. If the retailer attempted to evade his obligation, ethical considerations aside, he rendered himself liable to serious penalties. The consequences of the measure would have been even more serious had the business been a major one for a considerable number of retail merchants.

Ice cream has been subjected to a 20 per cent tax in two states. The intent of these measures was to raise the price of ice cream cones from five cents to six cents in both South Carolina and Kentucky. It is reported in respect of the former that retailers enjoyed marked increases of five-cent candy package sales and corresponding reductions in ice cream cone business.[40] In Kentucky the interference with ice cream cone business reduced sales by margins ranging from a few points to more than 60 per cent.[41] Many dealers undertook to shift the tax by simply maintaining the five-cents-a-cone rate and reducing the amount of ice cream in each cone. Since, however, selling cones is primarily a service business and the cost of the ice cream is not

[37] Melder, *World Situation and State Trade Barriers* (Apr. 1939) 12 STATE GOV. 68; and Taylor, Burtis and Waugh, *supra* note 33, at 28.

[38] See also Melder, *Trade Barriers Between States* (Jan. 1940) 207 ANNALS 54; and Martin, *Tax Competition Between States* (Jan. 1940) 207 *id.* 62, 66-67.

[39] While ice cream, soft drink, chewing gum, and other excise taxes were in effect in Kentucky in 1936-1937, the author had opportunity as Commissioner of Revenue to know how these statutes operated. In what follows this miscellaneous information forms the basis of facts regarding Kentucky not otherwise credited.

[40] Derrick, *Consumption Excise Taxes as Relief for the Tax Burden on Farm Property* (1929) 22 PROC. NAT. TAX ASS'N 263.

[41] See Martin v. Nocero, 269 Ky. 151, 106 S. W. (2d) 64 (1937); Shannon v. Hughes, 270 Ky. 530, 109 S. W. (2d) 1174 (1937).

a large proportion of total cost, the consequence of this policy was little better than that of adding the tax to the sale price or undertaking entirely to absorb it.

Another activity depending heavily on a customary five-cent price is the soft drink business. Certain data regarding taxes on this particular line are available for both South Carolina and Kentucky. In South Carolina, following imposition of the tax, there occurred a net reduction in the number of bottled-drink producers, in the fixed capital employed in the business, and in the value of the annual production. The value of the product, however, was cut less than other items. The facts in this particular case must be considered in the light of a general concurrent increase in other types of manufacturing.[42] The annual reports of the South Carolina Tax Commission indicate, on the other hand, that tax receipts gradually increased from $877,589 in 1926 to $1,046,245 in 1929. Moreover, the administrative official in charge indicated that in his judgment an excessive number of bottling plants had developed; and that the decline in number as well as the reduction in capital invested represented readjustments due to the previous over-expansion of plant capacity.[43]

A Bottlers' Association study of the operating statistics of the larger bottled-drink manufacturers before, during, and subsequent to enactment of the 20 per cent tax in Kentucky[44] showed that the rapid increase in the rate of the industry's growth in the state was retarded nearly 20 per cent although increase in out-of-state sales by the same producers continued at an accelerated pace. Moreover, after repeal of the tax in 1937, the bottlers regained the rate of increase in intrastate sales. Since the rate of gain was currently so great, however, it may be queried whether this showing is conclusive.

It has been asserted[45] that violation of the customary prices even in the case of so low a rate as that imposed by a state retail sales tax brings about serious consequences in the case of men's haberdashery stores.

Incidental restrictions on business may arise from excise taxes on commodities or services the demand for which is inelastic. In one sense the tax policy which interferes with a customary price is merely one instance of this class of restriction. It occurs, however, in such a manner that only within a narrow price range is there known to be considerable elasticity of demand. In the case of certain types of commodities and services, a tax at any price margin appears materially to reduce volume.

This consideration of elasticity of demand has special significance in those cases in which the policy is to avoid restrictive influences on business. It is important to realize that elimination of a tax already imposed does not necessarily rectify the damage which the measure has occasioned, particularly if it has been effective for a considerable length of time. The tax may have greatly curtailed the business of

[42] Derrick, *Consumption Excise Taxes for State Purposes* (1928) 8 U. N. C. (Ext. Bull.) STUDIES IN TAXATION 116.

[43] Tower, *Luxury Taxation and Its Place in a System of Public Revenue* (N. Y. Tax Comm., 1931) 86 n.

[44] *A Report by the Kentucky Bottlers' Association of Their Experience with the Special Soft Drinks Tax* (undated).

[45] Willemsen, *Operating Aspects of the Retail Sales Tax* (1932) 11 HARV. BUS. REV. 107.

some firms which have entirely retired. Again the ownership of businesses may have changed since the tax was enacted and its original impact felt by taxpayers. Thus, most of those who have been injured by the tax would not be aided if it were repealed; present enterprises would secure an unearned bonus. These considerations argue strongly for a large measure of stability in consumer-tax policy if the object of the state is to minimize interference with normal commercial activity.[46]

It must be kept in mind, moreover, that dealing with this kind of problem is complicated by the fact that frequently one cannot isolate the effect of the tax from that of other pricing factors. In many cases, also, the complication of business prejudice is present, so that one cannot estimate the extent to which the tax as such reduces volume of sales, as differentiated from the extent to which business is impaired by the unfortunate actions of management.

One interesting illustration is found in the 1932 federal tax on bank checks. This measure caused an average reduction in the volume of checks used of approximately 30 per cent, though the influence varied widely as between accounts. Thus, there was increased dependence on currency as a means of paying bills, particularly small ones where a two-cent tax is more than a negligible proportion of the total. If such a tax is imposed under conditions which require large use of currency, it provides a competitive demand for money which may interfere with other public purposes.

Most investigations of cigarette and gasoline tax effects have been made by interested parties, and there is some reason to believe that evidence contrary to the viewpoint of those conducting the studies was overlooked or not recognized. In the case of cigarette sales, for example, data have been circulated to show that the volume of cigarette business is much less in states that have cigarette taxes than in others. Thus it has been alleged that in non-taxing states cigarette consumption was 1,531 cigarettes per person, while in those imposing taxes it was only 932.[47] This statistician even goes so far as to apportion to non-taxing states the untaxed cigarettes sold in those states which do levy taxes. One figure is derived from state tax statistics, the other from federal statistics of withdrawals from manufacturing plants less the volume sold and *taxed* in those states which derive revenue from cigarettes. Of course, there is a real interference with the business when evasion of tax liability occurs.[48] The contrary hypothesis is suggested by the present writer that practically no long-run restriction on volume occurs by reason of the state or federal tax on cigarette sales if it is adequately enforced.

The same conclusion applies even more emphatically to gasoline taxation. Several students have presented evidence to show that increased state taxes cut consumption of gasoline, interfere with sales of motor vehicles, or otherwise impede motor fuel or vehicle business. A committee of the National Tax Association, studying substantially similar data in 1934, demonstrated that from 1932 to 1933 those states having

[46] SHOUP AND OTHERS, FACING THE TAX PROBLEM (1936) 245.

[47] *Cigarette Tax Blues: Tobacco Dealers Complain of Reduced Smoking* (July 29, 1939) BUS. WEEK 22.

[48] SHOUP AND OTHERS, *op. cit. supra* note 46, at 247.

the lowest gasoline tax rates showed decreases in fuel consumption, whereas those having higher rates showed increases; that those having the highest rates averaged mild increases in number of motor registrations, while those having the lowest rates averaged considerable decreases; and that those states which imposed local taxes in addition to state taxes averaged less decrease in gasoline sales volume than did states which lacked such measures. Its comment follows: "The committee desires to intimate that these data do not prove more than the figures submitted during the preceding years which suggested precisely the contrary conclusion. In a period of rapidly fluctuating business it is believed such data, standing alone, do not justify a generalized conclusion."[49] It would be erroneous to say that the gasoline tax does not affect the petroleum business. It is reasonably clear, however, that, at current prices, gasoline taxes up to six or seven cents a gallon in the aggregate do not materially change the volume of fuel consumption.

The parimutuel betting tax which has shown rapid growth in the United States in the past few years provides a more valid and general illustration of elasticity than does a cigarette or a gasoline tax. Race tracks where parimutuel betting is conducted secure most of their revenue from admissions to the track and from the "take" deducted from winning tickets. Thus a tax is on the track whether the state charges a daily license, an admission excise, or an impost on gross parimutuel turnover. If the admission charge is raised by reason of an admission tax, the number of persons who attend racing meets is reduced. Again, boosting the parimutuel take may cut the number of betters and in addition reduce the number of persons who attend the meet, and the average quality of the race horses that compete may be lowered. Thus, track managements are solicitous to prevent heavy parimutuel taxes. Still, no state which has recently imposed a tax on parimutuel wagering has abandoned the policy[50] and yet maintained legalized gambling.

Alcoholic beverage taxation illustrates invocation of elasticity of demand as a basis for deliberate control of consumption volume. The post-prohibition beer tax practice in the United States has sought to make the impost so moderate that malt beverage consumption would not be greatly cut, and hard liquor would be made less attractive. The whiskey tax policy in both the United States and Great Britain has sought to discourage consumption. Thus, the Colwyn Committee considered that the post-war English spirits taxes had decreased consumption but contended that such a decrease was certainly not inconsistent with sound public policy.[51] It is important,

[49] Martin and others, *Urgent Problems of Motor Vehicle and Related Taxation* (1934) 27 PROC. NAT. TAX ASS'N 274, 280. In *Effect of Gasoline Tax on Fuel Consumption* (Dec. 17, 1930) NAT. PETROLEUM NEWS, Mr. Harris and the present writer developed evidence that gasoline taxes do not restrict consumption even in the year following imposition except in the case of the very highest rates and except in those instances in which rates have been radically increased at one time.

[50] *Taxation of Parimutuel Wagering at Horse Races* (Ill. Legis. Council, 1940) PUB. No. 27.

[51] REPORT OF THE COMMITTEE ON NATIONAL DEBT AND TAXATION (1927) 213 and 223. In addition see SHOUP AND OTHERS, *op. cit. supra* note 46, at 197; Tax on Intoxicating Liquor, *Joint Hearings Before the House Committee on Ways and Means and the Senate Committee on Finance,* 73d Cong., interim 1st and 2d Sess. (1933); FOSDICK AND SCOTT, TOWARD LIQUOR CONTROL (1933); McConnell, *Liquor Traffic* (1933) 9 ENCYC. SOC. SCIENCES 505; Williamson, *Rates of Taxation of Beer and Spirits in Great Britain* (1934) 12 TAX MAG. 172.

in view of the generally admitted elasticity of demand for alcoholic products and particularly for any individual class of products, that legislative policy be formulated with a view to balancing revenue considerations against restrictive purposes at any particular stage. For example, Kentucky early in 1940 increased its spirits tax rates from $1.04 a gallon to $1.20 with the consequence that, despite a general upswing in tax revenues averaging approximately 17 per cent for the first half of the current fiscal year as compared with the same period of the preceding fiscal year, whiskey consumption revenues remained almost unchanged.[52]

Generalizations with respect to spirits apply with equal force to wines.[53] Pursuant to a recommendation by the State Department of Revenue,[54] Kentucky in 1940 reduced the tax on small wine bottles. "This reduction in the tax rate seems to have stimulated the consumption of wine in small containers and contributed to the upward trend in receipts from the wine consumption tax."[55]

Many discussions of tax theory rest on an assumption that tax administration is coordinate subject-matter rather than an aspect of tax theory. Certainly in many technical respects this assumption cannot be questioned. Recent experience makes it apparent, however, that the incidence and general economic effects of sales taxes are materially altered by administrative policy. Thus, administrative adequacy is certainly as significant an economic consideration in ascertaining the distribution of the tax load as is incidence theory in the narrow sense. Generally speaking, the difficulty in evenly shifting any consumer excise is well-nigh directly proportional to the extent of evasion.

It is thus important to find the reasons for poor administration and, in analyzing the distribution of the tax load, to consider the extent to which these imperfections can be eliminated. The most pervasive reasons for maladministration are lack of efficiency and of financial support. The main cure for the former appears to be improvement of field and office personnel, installation of a good system, and exclusion of partisanship from administrative policies. It is perhaps practically impossible to secure sufficient tax administration support, particularly because of the erroneous belief that performance at low cost means efficiency. A third factor contributing to inferior administration is our federal type of government. Impairment by this factor depends on the tax measure as well as on the geographical location of the state. Still a fourth variable bearing on administrative efficiency is margin of profit to the bootlegger. If the tax dodger can make a big gain from each operation the amount of evasion is likely to be much greater than if the income on each transaction is small. One illustration is the comparatively small volume of beer, as contrasted with the great amount of whiskey, tax evasion.[56]

[52] Ky. Dep't Rev., *Monthly Rep.* (Jan. 1941).

[53] Conlon, *Taxation in the Alcoholic Beverage Field* (1940) 7 LAW & CONTEMP. PROB. 737; Studenski, *supra* note 18, at 8.

[54] Ky. Dep't Rev., *Twenty-first Ann. Rep.* (1939) 19.

[55] Ky. Dep't Rev., *Twenty-second Ann. Rep.* (1940) 13.

[56] See further on the problems of consumption tax administration, Huston and Berryman, *supra* note 17.

Considerable evidence on the pyramiding of certain taxes is available. If the tax is levied early in the productive process, pyramiding is facilitated.[57] If the rate is high, pyramiding is more likely, as well as more significant, than otherwise. The following Kentucky illustration has been suggested:[58]

> The present $1.04 excise tax is paid by the wholesaler, who invariably classes it as part of the cost of the whiskey. Thus, his mark-up of 17 to 20 percent applies to the tax as well as the whiskey. The retailer's mark-up of 33 to 40 percent is based on his purchase price, and again includes a mark-up on the excise tax. Instead of increasing the retail price of whiskey 13 cents per pint, this tax results in an increase of 20 to 22 cents. Because of the point of application of the tax, an extra 7 to 9 cents is paid to the wholesaler and retailer.

Studenski has cited New York City price data to the contrary—statistics which, in fact, raise a question as to whether the entire federal tax is shifted forward.[59]

[57] Studenski, *supra* note 18, at 6-7.

[58] FOWLEY, ALTERNATIVE SOURCES OF REVENUE (1938) 1.

[59] See Studenski, *supra* note 18.

CONSUMPTION TAXATION AS AN INSTRUMENT OF ECONOMIC CONTROL

Albert Gailord Hart*

I

The proposition that taxation can and should be planned largely with a view to regulating economic activity is accepted, contrary to a sedulously cultivated popular tradition, by most economists of all schools. In view of the high percentage of national income absorbed by taxation, the types of taxes levied and the rates fixed cannot fail to influence profoundly the size and composition of our national output, and the way in which that output is shared. In consequence there is no issue as to whether taxation is to be allowed to have regulatory effects. The issue is only whether these effects shall be recognized, measured, and taken explicitly into account as a major element in framing tax policy, or whether they shall be publicly ignored and left to take the form of "riders" on measures ostensibly framed purely for revenue.

The principal regulatory effects, intentional or unintentional, of consumption taxes[1] may be classified roughly as follows:

(1) Effects on the *relative* consumption volume and prices of different sorts of goods.
(2) Effects on the *general* direction of change of consumption volume and prices.
(3) Effects on the distribution of the fruits of economic activity among persons and groups.

On the nature and extent of these effects, economists of all schools should be able to approach agreement; though the approach cannot be very close, since there is

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[1] By consumption taxes the writer means taxes proportioned either to the physical volume of some type of goods or services passing to consumers for household use or else to consumers' money outlay on such a type of goods or services. In addition to excise taxes and sales taxes, levied on sellers to consumers, this definition may be taken to include taxes levied on consumers directly (which for administrative reasons we do not have), either on particular purchases or on total spendings. Income taxes are clearly excluded by this definition; taxes on goods destined for consumers at the wholesale or manufacturing levels, being *approximately* proportioned to consumption volume, lie close outside the boundary the definition draws, and are covered by most of the analysis of this paper even where not explicitly mentioned. *Cf.* Studenski, *Characteristics, Developments and Present Status of Consumption Taxes, supra* this issue.

room for honest differences about various relevant questions of fact, and since it seems to be impossible to spell out the analytical procedure in enough detail absolutely to rule out illicit logical jumps.

It is harder to set forth a generally acceptable list of regulatory goals for consumption taxes. But the writer proposes the following:

(A) Justice in distributional effects. More concretely, this means in most contexts a tendency to reduce rather than increase the inequality of income distribution; though the writer can think of special cases where he feels just treatment would increase inequality.

(B) A high level of employment and production.

(C) Charging to particular producers and consumers special benefits obtained from government.

(D) Charging to particular producers and consumers costs which their operations impose upon others and which the market mechanism does not bring home to them.[2]

(E) Representation of social interests in greater or less use of particular articles, even though these interests cannot be accurately valued in money—for example, the public interest in reducing whisky consumption, protecting health by stimulating use of vitamin-rich foods, or diverting aluminum from kitchen uses to defense. This is very close in principle to goal (D), as is also goal (C).

While goals (C), (D) and (E) can on the whole be reconciled, real conflicts exist in some cases among goals (A), (B) and (C) and the principles of a desirable compromise solution are difficult to state.

II

In view of growing professional and public interest in the monetary effects of public finance, the body of this paper will be opened by considering possibilities of using consumption taxes as an auxiliary in a general program of stabilizing employment and production at satisfactorily high levels.

Consumption taxes immediately payable by sellers (as all actual consumption taxes are) drive a wedge between the price of consumer goods as paid by the consumer and the price as realized (net of tax) by the seller. Accordingly, the effect of such taxes in themselves—that is, assuming government expenditures and other tax rates would be the same whether or not these taxes were levied—is to discourage production of consumer goods.[3] For if prices to consumers rise, a given

[2] For example, operations at one oil well increase the amount of pumping necessary to raise oil at other wells in the same field; and if opening the well will not repay enough above its costs to cover the extra costs imposed on other wells, it is not socially desirable. If each well had to meet a tax representing these extra costs, opening of superfluous wells would be discouraged. Note that this presumption does not apply if the extra costs imposed elsewhere result merely from higher prices of labor equipment or materials rather than from impairment of technical efficiency. As the chief authors of this line of reasoning, Alfred Marshall and A. C. Pigou, have pointed out, it also indicates a claim to subsidy where operations produce benefits for which the producers are not able to collect—for instance where electrification of a suburban railway would improve living conditions in the neighborhood. This is not surprising since a subsidy or bounty is merely a tax with a minus sign. Most of the arguments of this paper relating to taxes apply, with sign reversed, to bounties as well.

[3] For an interesting discussion of the strongly analogous problem of payroll taxes see Kaldor, *Wage Subsidies as Remedy for Unemployment* (1936) 44 J. POL. ECON. 721.

amount of consumers' money outlay will buy fewer goods. But if prices to consumers do not rise, the prices realized by sellers will fall by the amount of tax, reducing incentives to produce. Prices to consumers can remain unchanged only if producers get costs reduced sufficiently to offset the tax; but this implies reducing wage rates and farm prices and thus reducing spending power, so that even at unchanged prices consumers can buy less.

Where proceeds of consumption taxes are applied to government spending which would otherwise be impossible, or to reduction of other taxes, this adverse effect on production will be attenuated, or in the most favorable case cancelled. If a by-product of the tax is to pour into consumption markets exactly as much money as the taxes drain off, net proceeds of sellers after taxes will be unaffected. The price paid by consumers will be increased, reducing the amount of goods the previous consumers can buy; but the people who get the extra funds will be able to buy more goods. In practice, however, a complete offset cannot be expected. Even in the most favorable case, that where the consumption taxes in question are levied by state or local governments which insist on balancing their budgets, not all the proceeds of the tax will take the form of consumer spending. If the proceeds go to additional salaries (even to additional relief payments), part will be saved by the recipients; and even more will be saved if the proceeds go to reduce income taxes or property taxes.[4] Some adverse effect on consumer goods output must thus be expected; a minimum if proceeds all go to relief payments which would otherwise be impossible, a maximum if proceeds are net, other taxes and government expenditures being undisturbed, as is likely if federal taxes are being considered.

It follows from this argument that consumption taxes can play a useful role in economic stabilization if (and only if) the stabilization program calls for reducing the incentives to produce consumer goods. It is generally agreed that there is no use discouraging consumer goods production in the trough of the business curve; the issue in regard to consumption taxes is, therefore, whether they can usefully be levied in peak years.

At first glance, it is tempting to argue that the way to smooth the fluctuating curve of production and employment must be to level off the summits and fill in the valleys. Admitting that it would be better to raise the valleys without lowering the summits, stabilization at some sort of average level might have advantages over allowance of wild fluctuations. But it is by no means clear that flattening the peaks would raise the valleys. Even where full prosperity has not been attained, very sweeping business declines are possible; witness the United States in 1937-1938 and Austria in 1929-1932, both starting from depression levels. To propose discouraging consumption output at the peak is clearly dangerous.

In one rather important case, there is merit in reducing incentives for production. That is in the case where physical barriers make these incentives ineffective and

[4] For indication of the purposes to which consumption tax revenues are put, see Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes, infra* this issue.

create a danger of their running off into needless increases of prices and profits. Where a rise in consumers' outlay cannot bring about a rise in output of consumer goods, tax diversion of outlays is in order to avoid inflation. This is likely to be the case in every wartime boom, and may sometimes be the case in peacetime.

To admit a possible use for taxes to constrict consumers' money outlay, however, is not yet to justify use of consumption taxes for the purpose. Such taxes as we know them have the very great demerit of being regressive, in conflict with goal (A). A set of excise taxes or sales taxes designed to avoid this demerit would have to be confined to goods on which the rich spend a larger percentage of their income than do the poor, which would very sharply limit the tax base. The monetary purpose in view could be served without conflict with goal (A) by levying direct taxes on individuals with exemptions for minimum needs, and with progressive rates. Conceivably these taxes might be on consumption outlays as such (a new form of consumption tax); but both equity and administrative convenience suggest use of the income tax. Consumption taxes could be justified for this purpose only if income taxes were unavailable and the inequities of inflation were considered worse than those of levying the consumption taxes proposed.[5]

The idea of cyclical use of consumption taxes has one very important residue, however; depression can be mitigated by getting rid of consumption taxes and intensified by creating new ones. The epidemic of sales and excise taxes in 1932-1935 probably had serious adverse effects on business activity, not to mention its effects on the fairness of the distribution of tax burdens. The next time we suffer the misfortune of a major depression, we should make it the occasion for a concerted move against indirect taxes.

III

Since consumption taxes are in their administrative nature taxes which apply by special prescription to individual commodities,[6] their natural field of usefulness is where differential treatment of commodities is warranted. The nature of this field was indicated in the introduction to this paper; but it needs futher examination.

Applying a tax to a particular consumption good (or removing such a tax) has two types of effects to be watched:

(1) It discourages (or encourages) use of the commodity by its previous buyers, reducing consumption volume.

(2) It reduces (or raises) the incomes which arise from the production of the commodity.

Sometimes one of these effects is to be desired and the other is to be regarded as an unfortunate by-product; sometimes both are desired.

An example of emphasis on the effect on consumption is liquor taxation. A

[5] The argument for this position, in a context of inflation dangers arising from defense, is set forth briefly in the writer's pamphlet, *Economic Policy for Rearmament* (University of Chicago Press, Nov. 1940) 22-27, and in more detail in the forthcoming volume cited *supra* note *.

[6] Even sales taxes in practice must proceed by enumeration of things taxable.

good deal of sentiment in the country favors limitation of liquor consumption; and taxation is welcomed largely on this ground. But the growth of the industry since Repeal has been so rapid that nobody has been much concerned about restricting the income of those connected with it. Vested interests in such income have not been recognized, and revenue and sumptuary considerations have ruled the roost.

At the other exteme is the problem of taxing increases in house and apartment rents which may result from housing scarcities under the defense program. Such taxation could be justified as a sort of excess profits tax, catching windfalls to landlords who merely happen to be fortunately placed. This justification would be purely on income grounds; the very reason for the windfall is that the supply of housing cannot quickly respond to higher rents, so that consumption, *i. e.* use of housing, would not be affected one way or the other.

The problems of defense also offer a convenient example of an intermediate case in which both consumption and income distribution considerations point the same way. Before defense develops much beyond the present stage, it is likely to require resources now used for automobile production; private purchases of new cars must therefore be restricted. If the number sold is reduced, higher prices can be charged. But there is no special reason why automobile manufacturers and dealers should be allowed to pocket the increase. Levying a substantial excise on new cars is likely to commend itself as a system for curtailing purchases by raising prices without unjustly enriching the sellers.

Aside from political and administrative considerations, it will be noticed, necessary restrictions of consumption could be taken care of by rationing, and prevention of windfalls in such situations by price-fixing. The combination of a higher price to consumers and an excise tax upon producers is a make-shift substitute which is plainly inferior to *ideal* and costless rationing and price-fixing. But it is not necessarily or even probably inferior to actually *practicable* rationing and price-fixing. The controls which would be necessary to take care merely of liquor, housing and automobiles would absorb a large part of the administrative resources of government, and even so would have to act either by crude rules giving very unfair allocations or with a degree of discretionary authority which would be highly dangerous. The fact that taxation can restrict consumption and catch windfalls without creating a necessity for planning the consumption of every household makes it possible to save bother and to avoid moving too far toward a government of men. In a democracy, rationing and price-fixing must remain emergency devices for limited application; and working substitutes have a high value.

Cases do arise where consumption and income effects conflict. At the present time, for example, tobacco is considered by most of us a very harmless enjoyment; and a reduction of cigarette taxes and prices to permit more consumption would be very welcome to smokers, especially in the lower income brackets. But the cigarette taxes have largely embedded themselves in the values of factories and lands

used for tobacco production. To repeal them would give windfalls to the interests which now own this property. Cigarette taxes are thus covered in part by the traditional rule that "an old tax is a good tax," a rule which applies, of course, only to taxes affecting values of durable goods.

Fortunately, discriminatory income effects among producer groups resulting from changes in consumption taxes can be expected to iron themselves out in a few years, if they do not take hold on land values or on very specialized human skills. For moderate long-range adjustments aimed to give fair assessments of benefits from government services or to bring home social costs to nuisance-mongers, as by taxing use of soft coal without smoke arresters, such income effects may legitimately be disregarded. They are important chiefly for sudden and large adjustments such as are likely to be involved in the defense program.

IV

Down to this point, only the regulatory aspect of consumption taxes has been considered, to the exclusion of revenue and collection costs. This exclusion, although immediately dictated by the scope suggested for this paper, conforms, the writer feels very strongly, to the basic principles of public policy on which taxation should rest. The closing paragraphs will be devoted to arguing the proposition that revenue and collection cost should be given only secondary weight in considering consumption taxes.[7]

If revenue from these taxes were essential to the functioning of government, their revenue aspect would of course be central. But while this has been true in the past, it is not true at present either for our Federal Government or for any except the most completely rural state governments. The income tax is well developed in the federal system and has proved its adaptability to the uses of state governments where the states are fairly industrialized and urbanized. There is an old and well-founded rule in economics to the effect that any revenue that could be raised by indirect taxes, can be raised more equitably by direct taxes on incomes and inheritances; the only first-order corrections to this rule are for ill effects which can be obviated by permitting averaging of tax liability over a few years and by proper interpretation of taxes to the public.

The ease of collection of neatly designed indirect taxes is a standing temptation to the legislator. But such taxes are no longer so "painless" as they used to be; gasoline taxes, sales taxes, tobacco taxes, and liquor taxes in particular, are brought forcefully to the attention of the consumer. This development should make it possible to exclude the use of consumption taxes as sources of general revenue. Needless to say, if such taxes are used where regulatory considerations call for them, the total revenue they produce will be substantial, though probably a good deal less than at present. But the rule of policy should be to regard revenue as the by-product and regulation as the main product in looking at all indirect taxes, relying for revenue upon income taxes.

[7] Contrast the views of Pierce, *The Place of Consumers' Excises in the Tax System*, *supra* this issue.

THE DISTRIBUTION OF REVENUES FROM STATE-COLLECTED CONSUMER TAXES

L. Edwin Smart* and John N. Hart†

The development of consumer taxes on a large scale is, so far as state and local governments are concerned, a comparatively recent phenomenon. Universal as was the motor fuel tax by 1929, it was not until the early nineteen-thirties that taxes of this character were turned to as an important source of revenue. The extent of their development can best be grasped by a study of Table I.

Table I

State Tax Collections, Selected Years, 1925-1940
(In millions of dollars)

	Major Sources of Sales Tax Collections						
Year	*General Sales*	*Motor Vehicle Fuel*	*Alcoholic Beverage*	*Tobacco*	*Total*	*Grand Total of All Collections*	*Per Cent of Grand Total of All Collections Accounted for by Four Major Types of Sales Taxes*
1925[a] ..	—	87.4	—	[b]	87.4	1107.4	8
1930[a] ..	1.2	468.6	—	10.5	480.3	1780.3	27
1932[a] ..	1.3	519.6	—	17.6	538.5	1619.3	33
1937	434.4	721.8	177.0	54.4	1387.6	3013.5	46
1938	446.8	777.2	174.7	55.4	1454.1	3132.4	46
1939	440.1	800.9	174.3	59.5	1474.8	3085.0	48
1940	490.2	845.4	200.0	97.1	1632.7	3327.2	49

(a) Local shares not included.
(b) Not separately reported.
Source: United States Bureau of the Census, State Tax Collections (1940) 29 and 30.

Although the data are not strictly comparable throughout, the trend is clear; an ever-increasing share of state tax collections has been accounted for by general and selective sales taxes. In spite of the fact that during the fifteen-year period all state tax collections increased three-fold, the yields from these sources rose even more rapidly.

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In 1925 probably about one-tenth or one-twelfth of the revenues of the states came from such taxes. Fifteen years later they were accounting for approximately one-half of the total. The percentage of the total collections accounted for by consumer taxes has shown a very definite tendency to stabilize during recent years. It seems probable, however, that the aggregate amount of revenue from sales taxes will continue to increase.

It is to the circumstances under which this resort to consumer taxes was had that one must turn in order to understand the problems of revenue distribution which their use has raised. Concomitant with the decline, and in some cases the drying up, of existing sources of governmental revenue, the great depression created pressing demands for larger and larger expenditures by government. Two factors, therefore, led to legislation directed at the potential taxable capacity of consumption goods and services: (1) the need for replacement of revenue lost or diminished through one cause or another; (2) the need for new sources of revenue or an increase in existing sources for new functions or to meet increased demands upon preexisting functions of government. At the same time it was in large part necessary to turn to that level in the state governmental hierarchy possessing the greatest tax-gathering power. As between a state and the local units of government within its framework, the former will usually be the stronger. To the state legislative body, therefore, went the major task of tapping the comparatively undeveloped resources of consumption taxation, not alone for the requirements of the state government but as well for those of the lesser political units in the commonwealth.

Thus did consumer taxes take their rapid rise in a complex of functional and geographical considerations. Motor fuel taxes well illustrate the point. Although state-collected, the tax monies were in many jurisdictions to be shared by the highway funds of the state, the counties, the townships and the municipalities. Beyond this lay a demand that this lucrative source of tax monies be tapped to aid in supporting such new functions as the staggering ones of unemployment and old-age relief. If allocation to local political units were to be handled effectively, there were difficult choices to be made as to method; if diversion to alien purposes was to be considered, some guiding principle would be necessary. Often the two demands would be intermingled, thus adding complexity to complexity. In these circumstances, techniques for the imposition and collection of consumers' taxes constituted only a part of the problem facing the state legislative bodies. It was not enough to bring the new revenues into the state treasury; they must be dispatched to the places needed for the required purposes at the right time and in the proper amounts. Here are four independent but interacting variables around which revolve all the difficulties that arise in the distribution of collections from taxes on consumption.

Allocation of Revenues

It is possible to distribute the revenues from the state treasury to the minor civil subdivisions by means of a system of (1) grants-in-aid, or (2) sharing. To many people the former usually connotes weakness and a lack of universality of need.

In other words the area or subdivision receiving a grant has admitted its financial inability to support the required functions of government. Since some degree of financial stigma is attached to a request for a grant, a community may refuse to ask for assistance when such help may be in the interest of the whole commonwealth. If assistance is universally required—in a geographical sense—the tax-sharing method which has developed during the last two decades may seem to be the better solution.[1] From a practical point of view, however, it makes little difference whether local governments are aided by means of grants or by means of sharing. For while the two forms of aid have different philosophical bases which might be expected to lead to different allocation formulas, in practice no hard and fast lines can be drawn between them.[2]

Allocation Formulas

Desirable as it may be, it is probable that no single "ideal" formula, whether applied to a system of grants-in-aid or applied to a system of sharing, can be devised which will allocate revenues collected by the state to its minor subdivisions, where they are to be assisted, in exactly the right proportions. The outline which follows is an attempt to present the more generally used bases for distributing to the local units the revenues from state-collected, locally-shared taxes.

METHODS OF ALLOCATING REVENUES TO LOCAL GOVERNMENTS

1. *Population:*
   a. Total population.
   b. Number of school children or a combination of number of school children multiplied by number of days in school and generally known as average days' attendance.
   c. Population over or under certain ages.
   d. Number of motor vehicle owners or motor vehicle registrations.
2. *Valuation of property:*
   a. Total value of all property for preceding year.
   b. Total value of property based upon the average of a number of preceding years.
   c. Valuation of some particular form of property such as real estate.
   d. Valuation of property according to location such as amount located inside incorporated municipalities.
3. *Place of origin.*
4. *Area:*
   a. Square miles or some other unit of area.
   b. Total mileage of roads of various types, such as county roads.

[1] Another method of distribution which, in the opinion of the writers, merits more than the little consideration it has received is a reexamination of functions and activities of each level of government to the end that they may be redistributed. For example, the situations which give rise to the various forms of public assistance under the Social Security Program are state-wide in most cases and much can be said for inducing the state governments to take it over in its entirety. Such a course would have the great advantage of simplifying the problem of disposing of revenues earmarked or dedicated to public assistance.

[2] Excellent treatment of grants-in-aid will be found in BITTERMAN, STATE AND FEDERAL GRANTS-IN-AID (1938). On tax sharing, see HUTCHINSON, STATE-ADMINISTERED LOCALLY-SHARED TAXES (1931); TAX RELATIONS AMONG GOVERNMENTAL UNITS (Tax Policy League, 1938) Pt. III; GROVES, FINANCING GOVERNMENT (1939).

5. *Equally:*
   a. Equal amounts to each subdivision within the state; generally confined to counties and townships.
6. *Previous years' expenditures:*
   a. For all purposes.
   b. Some particular purpose, such as relief.

The first three of these six methods are the most widely used throughout the nation. Many states, however, distribute motor fuel taxes on the basis of mileage or equally to both counties and townships. It is not unusual, furthermore, to find several of these methods used in combination after the revenues have been divided into parts, each part being distributed according to a different formula. For example, one-half of the yield of a tax may be distributed to the counties in the proportion that the population of each county bears to the total population of the state and the other one-half to the school districts in the proportion that the average daily attendance of the district bears to the total average daily attendance in the state as a whole. Any evaluation of the various methods of allocation must finally be dependent upon the particular tax and the purpose for which it was levied.

The allocation of the revenues from consumption taxes on the basis of total population has the advantage of being most easily understood by the people and often the most expedient politically. On the other hand, it is defective in failing to take into consideration the needs of the local subdivisions. For example, if the tax has been levied for the purpose of aiding them in the financing of relief, allocation of the revenue according to population would not take into consideration that in recent years a greater proportion of the population in large cities has been unemployed than has been true of rural areas.

Often a particular segment of the population will furnish a more logical and equitable method of distribution than will the total. If a consumption tax has been levied for the purpose of defraying the cost of public schools there is, of course, merit in distributing the money to the districts in proportion to the number of children of school age or actually attending the schools in each district. No attempt will be made to discuss equalization since it partakes of the character of a grant-in-aid from state funds, thus disregarding the yield of the tax which is of most concern here.

Many of the consumption taxes enacted during the thirties were designed to replace revenues lost through the decline in the value of property, particularly tangible property. In some states they were enacted in order that the burden of taxation borne by the owner of property might be reduced. In these cases the distribution of revenues in proportion to the assessed value of property has a logical appeal. This is especially true if the appraised value of the property and the rates of taxation have been fairly uniform throughout the state. It is well known that the density of population and the value of tangible property are highly correlated. It follows that the results attained in distributing revenues either according to population or

according to value of property will be almost the same. Since, however, a census is taken only once in a decade while appraisements are usually more frequently made, the latter method is likely to be more nearly in keeping with the economic situation at any given time.

It has been argued that the allocation of revenue on the basis of assessed valuation will place a desirable premium upon keeping such valuations near their true value. If there were no other factors affecting the appraisal of property there is no good reason to believe that this would not be the result. Actually there are many other elements to be considered in changing valuations, especially upward. There is no evidence that the objective has been attained or even approached in any given state.

The distribution of the "local government fund" in Ohio is a good illustration of the use of "valuation of property according to location" as a method of allocating revenues to local governments. When the retail sales tax was first levied in 1935, 40 per cent of the revenue was placed in the "local government fund" after certain fixed appropriations had been deducted. Since 1939, $12,000,000 of sales tax revenue each year has been placed in the local government fund. This fund has always been distributed among the counties according to the ratio of the tangible property inside incorporated municipalities of a county to the total value of tangible property inside incorporated municipalities within the state. This method tends to distribute the major portion of the fund to the eight large urban counties. In fact these counties receive approximately 70 per cent of the fund although they only account for about one-half of the population of the state.

Wealthy communities are very insistent that local shares be allocated on the basis of "origin." Every federal, state and local tax administrator has had to meet this issue at one time or another. One often hears it stated that if New York or Pennsylvania or Ohio received from the Federal Government all the tax monies the residents of those states pay in to the federal treasury there would be no difficulty in financing the state and local governmental functions within them. Similarly, the officials of municipal governments within whose boundaries retail establishments are most likely to be found will insist that revenues collected from taxes on retail sales should be returned to them. They forget that their municipality is a market center for individuals who dwell in communities which must maintain governmental services but which have no market outlets. There is involved in this reasoning the assumption that the incidence of the tax is upon the vendor, an assumption most difficult to defend in the case of consumer taxes.[3] The adherents of this method have relied almost solely upon political appeal, probably realizing that any attempt to give it a sound theoretical basis would be a feeble one.

At the present time there seems to be little defense for using area as a basis for allocating funds. No doubt hypothetical situations could be devised which would

[3] On the incidence and ultimate impact of consumption taxes, see Martin, *Distribution of the Consumption Tax Load*, *supra* this issue.

give support to this method. In rural areas requiring the same type of highway and where mileage varies directly with area, it might be defended. But few areas today would even approximate these conditions. Another method similar to that based upon area but with much more to recommend it is that sometimes used in distributing the revenues from motor fuel taxes. This method is to allocate according to the mileage which exists within the boundaries of a given governmental unit. If the traffic density and the type of surface within the area are the same throughout, it furnishes an excellent basis for allocating the revenues. Furthermore, and this is no mean advantage, it is easily understood by the taxpayer.

The equal distribution of funds among local governments seems absolutely unwarranted. At best it can be supported only from the point of view of expediency and when used in combination with some other method. It is well illustrated in the distribution of the motor vehicle license tax in Ohio. After certain deductions for claims and administration, the state highway department receives 23 per cent of the revenue, the counties receive 47 per cent allocated on the basis of motor vehicle registration, the municipalities receive 25 per cent on the same basis, and the remaining 5 per cent is distributed equally among the 88 counties.

As a general rule the most economical use of tax revenues will not result if they are distributed in proportion to previous years' expenditures. Those expenditures have been in part accidental or nonrecurrent. Furthermore, this method may encourage unnecessary expenditures just to get a greater share of the state-collected tax revenue. Most important of all, it does not recognize the need of the governmental unit. It is possible that the unit requiring the most assistance would be the one where expenditures, because of lack of funds, had been kept at a minimum; while in some other unit the expenditures would be unnecessarily high simply because the revenue was available.

Extent of Allocation

The multiplicity of formulas must not be allowed to obscure the fact that, as Table II forcefully shows, local governments today share significantly in state-collected consumer taxes. The table reveals that, in 1940, out of nearly one and two-thirds billion dollars derived from state-collected consumer taxes, approximately 14 per cent found its way back to the local governments. Furthermore, this is the minimum since the Bureau of the Census, which compiled the data, in some instances, classified "collections 'For State' because they are first deposited in funds containing receipts from several sources, and are therefore considered as grants from unspecified sources" although they may have been "reported by state officials as apportioned to local units."

The absence of general sales taxes is notable in the case of the New England states. This section of the country apparently relies to a considerable extent upon its state governments to perform the services desired. This is brought out by the fact that Massachusetts is the only state in the section which apportions any of the

Table II

Revenue and Allocation from Sales Taxes, by State, 1940

(In thousands of dollars)

Division and State	Total Revenues			General Sales			Motor Fuel			Alcoholic Beverages			Tobacco Products	All Other
	Total	State	Local	Total	State	Local	Total	State	Local	Total	State	Local		
Total	*$1,647,376*	*$1,415,392*	*$231,981*	*$490,188*	*$459,860*	*$30,328*	*$845,423*	*$665,574*	*$179,849*	*$199,969*	*$178,561*	*$21,408*	*$97,050*	*$14,746*
New England	*77,140*	*70,024*	*7,116*	—	—	—	*48,131*	*41,015*	*7,116*	*15,577*	*15,577*	—	*13,192*	*240*
Maine	7,399	7,399	—	—	—	—	6,133	6,133	—	1,165	1,165	—	—	101
New Hampshire	5,381	5,381	—	—	—	—	3,746	3,746	—	560	560	—	1,075	—
Vermont	4,169	4,169	—	—	—	—	2,703	2,703	—	965	965	—	501	—
Massachusetts	36,963	29,847	7,116	—	—	—	21,134	14,018	7,116	8,329	8,329	—	7,361	139
Connecticut	17,980	17,980	—	—	—	—	10,568	10,568	—	4,558	4,558	—	2,854	—
Rhode Island	5,248	5,248	—	—	—	—	3,847	3,847	—	—	—	—	1,401	—
Middle Atlantic	*242,851*	*208,819*	*34,031*	*8*	*8*	—	*151,210*	*130,085*	*21,125*	*57,782*	*44,876*	*12,906*	*33,513*	*338*
New York	126,899	105,127	21,772	1	1	—	70,930	62,064	8,866	34,160	21,254	12,906	21,530	278
New Jersey	32,661	27,528	5,133	—	—	—	23,272	18,139	5,133	9,329	9,329	—	—	60
Pennsylvania	83,291	76,164	7,126	7	7	—	57,008	49,882	7,126	14,293	14,293	—	11,983	—
East North Central	*463,308*	*394,627*	*68,681*	*225,715*	*213,715*	*12,000*	*171,593*	*118,553*	*53,040*	*52,144*	*48,514*	*3,630*	*11,568*	*2,288*
Ohio	138,869	110,405	28,465	50,985	38,985	12,000	51,428	34,963	16,465	26,083	26,083	—	8,679	1,694
Indiana	53,020	44,523	8,497	23,538	23,538	—	24,565	16,068	8,497	4,917	4,917	—	—	—
Illinois	145,599	124,059	21,539	90,818	90,818	—	43,687	22,159	21,528	10,502	10,502	—	—	591
Michigan	95,909	89,359	6,550	60,374	60,374	—	31,243	24,693	6,550	4,290	4,290	—	—	3
Wisconsin	29,911	26,281	3,630	—	—	—	20,670	20,670	—	6,352	2,722	3,630	2,889	—
West North Central	*156,879*	*124,738*	*32,141*	*57,561*	*41,788*	*15,773*	*78,939*	*63,322*	*15,617*	*15,484*	*15,119*	*365*	*4,642*	*253*
Minnesota	23,631	17,416	6,215	—	—	—	18,646	12,431	6,215	4,985	4,985	—	—	—
Iowa	37,064	22,561	14,502	16,859	7,437	9,422	16,771	11,691	5,080	1,166	1,166	—	2,177	91
Missouri	41,723	41,723	—	23,019	23,019	—	13,904	13,904	—	4,674	4,674	—	—	126
North Dakota	7,067	5,938	1,129	3,099	3,099	—	2,292	1,528	764	1,133	768	365	510	33
South Dakota	11,839	11,839	—	4,504	4,504	—	5,412	5,412	—	1,258	1,258	—	662	3
Nebraska	13,598	10,040	3,558	—	—	—	11,860	8,302	3,558	1,738	1,738	—	—	—
Kansas	21,957	15,221	6,737	10,080	3,729	6,351	10,054	10,054	—	530	530	—	1,293	—
South Atlantic	*188,632*	*166,864*	*21,768*	*30,816*	*30,816*	—	*128,272*	*109,379*	*18,893*	*20,645*	*17,770*	*2,875*	*5,385*	*3,514*
Delaware	2,862	2,862	—	—	—	—	2,205	2,205	—	619	619	—	—	38
Maryland	16,791	14,826	1,965	—	—	—	11,231	9,266	1,965	4,362	4,362	—	—	1,198
Virginia	19,869	19,549	320	—	—	—	18,236	17,916	320	1,633	1,633	—	—	—
West Virginia	30,438	30,438	—	18,608	18,608	—	10,690	10,690	—	1,140	1,140	—	—	—
North Carolina	40,316	40,316	—	12,208	12,208	—	25,946	25,946	—	2,162	2,162	—	—	—
South Carolina	20,595	15,589	5,006	—	—	—	12,839	10,708	2,131	3,010	135	2,875	2,559	2,187
Georgia	27,990	24,513	3,477	—	—	—	21,614	18,137	3,477	3,459	3,459	—	2,826	91
Florida	29,771	18,771	11,000	—	—	—	25,511	14,511	11,000	4,260	4,260	—	—	—
East South Central	*95,332*	*75,450*	*19,882*	*14,502*	*13,452*	*1,050*	*60,524*	*42,609*	*17,915*	*6,939*	*6,022*	*917*	*10,637*	*2,730*
Kentucky	20,976	20,976	—	3	3	—	13,458	13,458	—	3,908	3,908	—	1,724	1,883
Tennessee	24,598	18,190	6,408	—	—	—	19,664	14,173	5,491	1,949	1,032	917	2,893	92
Alabama	26,792	18,139	8,653	7,756	6,706	1,050	15,301	7,698	7,603	359	359	—	3,344	32
Mississippi	22,966	18,145	4,821	6,743	6,743	—	12,101	7,280	4,821	723	723	—	2,676	723
West South Central	*145,274*	*136,306*	*8,966*	*23,939*	*22,434*	*1,505*	*89,707*	*82,876*	*6,831*	*12,316*	*11,685*	*631*	*15,651*	*3,661*
Arkansas	20,563	19,311	1,252	5,514	5,514	—	11,013	9,761	1,252	2,422	2,422	—	1,593	21
Louisiana	35,785	31,673	4,112	7,473	5,968	1,505	18,251	15,644	2,607	3,078	3,078	—	4,672	2,311
Oklahoma	29,619	26,015	3,602	10,952	10,952	—	14,495	11,523	2,972	661	30	631	2,182	1,329
Texas	59,307	59,307	—	—	—	—	45,948	45,948	—	6,155	6,155	—	7,204	—
Mountain	*67,197*	*61,951*	*5,246*	*23,178*	*23,178*	—	*37,288*	*32,042*	*5,246*	*6,041*	*6,041*	—	*359*	*331*
Montana	5,795	5,795	—	—	—	—	5,030	5,030	—	753	753	—	—	12
Idaho	5,570	4,570	1,000	—	—	—	5,281	4,281	1,000	222	222	—	—	67
Wyoming	5,044	4,355	689	1,961	1,961	—	2,756	2,067	689	327	327	—	—	—
Colorado	20,598	18,424	2,174	8,810	8,810	—	9,252	7,078	2,174	2,306	2,306	—	—	230
New Mexico	9,892	9,892	—	4,198	4,198	—	4,975	4,975	—	719	719	—	—	—
Arizona	10,018	8,635	1,383	4,010	4,010	—	4,610	3,227	1,383	1,398	1,398	—	—	—
Utah	8,571	8,571	—	4,199	4,199	—	3,874	3,874	—	117	117	—	359	22
Nevada	1,709	1,709	—	—	—	—	1,510	1,510	—	199	199	—	—	—
Pacific	*210,763*	*176,613*	*34,150*	*114,469*	*114,469*	—	*79,759*	*45,693*	*34,066*	*13,041*	*12,957*	*84*	*2,103*	*1,391*
Washington	42,547	33,375	9,172	20,689	20,689	—	16,234	7,062	9,172	2,130	2,130	—	2,103	1,391
Oregon	12,982	12,898	84	—	—	—	12,381	12,381	—	601	517	84	—	—
California	155,234	130,340	24,894	93,780	93,780	—	51,144	26,250	24,894	10,310	10,310	—	—	—

Source: U. S. Bureau of the Census, State Tax Collections (1940) 16 and 17.

revenue from consumer taxes to its local units, and this is true only for motor fuel taxes. Rhode Island is the only commonwealth which does not collect taxes on alcoholic beverages. All but seven of the states retain the collections from the last-named source for their own purposes. Over one-half (25) of the states levy taxes on tobacco products and Kansas is the only state sharing with localities according to the classification established by the Bureau of the Census. Peculiarly enough, all eight of the South Central states levy tobacco taxes. In no other section of the country does every state impose this type of tax. It is interesting to note that sharing is most nearly nation-wide and greatest in the case of the revenues from motor fuel taxes. In fact well over one-fifth of the receipts from this source find their way back to local units although only 30 of the 48 states apportion any of these revenues to their minor subdivisions.

The revenue from the motor fuel tax accounted for slightly over one-half of the total collections from consumer taxes in 1940. General sales taxes ran a poor second but it must be kept in mind that some of the wealthiest states in the Union, the New England and Middle Atlantic states, did not make use of them. This is forcefully brought out by noting the revenues which they collect from other types of taxes on consumer goods. Nearly one-fourth of the motor fuel tax revenues, over one-third of those from alcoholic beverages and nearly one-half of those from tobacco products are collected from the nine states in these two sections.

If state governments share the receipts from consumer taxes with their local subdivisions to the extent, on the average, of about one-seventh, stated inversely about six-sevenths is retained by the states. The percentage of the total collections withheld by the various state governments in 1940 is shown in Table III, which should be read in connection with Table II.

The West North Central and the East South Central sections of the nation were the most liberal with their subdivisions. On the average these states, of which there are eleven, sent more than one-fifth of the collections back to their local units although three of them did not return one red cent. Iowa returned nearly two-fifths and Florida nearly three-eighths to rank first and second from the point of view of sharing. The citizens of the local governments of the four West South Central states probably felt that their state governments were extremely parsimonious. They received slightly less than one dollar out of sixteen collected from consumers. The Mountain and New England state governments retained, on the average, over 90 per cent of the collections in their own treasuries.[4] Exactly one-third (16) of the states kept all receipts for their own use.

It should be clear from Tables II and III that the revenues from state-collected consumer taxes which are being distributed to local governments are quite sufficient in amount to warrant concern over the problem of sharing. But sharing is only one of the difficulties to be faced in the distribution of revenues. It is possible to

[4] At the November, 1940, elections, Arizona, retaining 86 per cent of all consumption taxes collected by it, and Oklahoma, retaining 88 per cent, both rejected initiated proposals for greater sharing of gasoline taxes. See (1941) 30 NAT. MUN. REV. 122.

Table III

Per Cent of All Consumption Taxes Actually Retained by State Governments, 1940

61% to 70%		*71% to 80%*		*81% to 90%*		*91% to 100%*	
Alabama	68	Minnesota	74	Arizona	86	Arkansas	94
Florida	63	Mississippi	79	California	84	Connecticut	100
Iowa	61	Nebraska	74	Colorado	89	Delaware	100
Kansas	69	Ohio	80	Georgia	88	Kentucky	100
		South Carolina	76	Idaho	82	Maine	100
		Tennessee	74	Illinois	85	Michigan	93
		Washington	78	Indiana	84	Missouri	100
				Louisiana	88	Montana	100
				Maryland	88	Nevada	100
				Massachusetts	81	New Hampshire	100
				New Jersey	84	New Mexico	100
				New York	83	North Carolina	100
				North Dakota	84	Oregon	99
				Oklahoma	88	Pennsylvania	91
				Wisconsin	88	Rhode Island	100
				Wyoming	86	South Dakota	100
						Texas	100
						Utah	100
						Vermont	100
						Virginia	98
						West Virginia	100
4		7		16		21	

Source: Table II.

direct the yield from a given tax to a specific function with or without sharing. That is, the state may "earmark" the receipts for a clearly defined function such as highways and, at the same time, not allocate them to its minor subdivisions. It is interesting to note, however, that the terms, earmarking and allocation, are tending to become synonymous in many respects. If the central government institutes a policy of sharing revenues it will usually not be long until local government authorities will begin to insist that the shared revenues were originally earmarked for these governments.

Earmarking of Revenues

Earmarking seems historically to have been in large part the result of accident rather than of design and is much older than recent controversy would seem to indicate. No doubt, the opinion held in this country that earmarking is a development of the last two decades grows out of the fact that, as a general policy, the Federal Government has not resorted to it. The constitutional requirement that direct taxes—not the revenue therefrom—must be apportioned among the states according to population immediately became an effective barrier to their use. Congress was compelled, therefore, to resort to customs and internal revenue duties to

obtain revenue sufficient to carry on the functions of government. A tariff law was enacted as early as July 4, 1789, and every school child recalls that President Washington called out the National Militia, in 1794, to quell the "Whiskey Rebellion." Some of the federal excises have had as their aim the regulation or restriction of the use of certain commodities rather than the production of revenue; but none has been earmarked for a specific function of government.

It is nevertheless true that, even as early as the time the Constitutional Convention met in 1787, earmarking was practiced in England. Historians of taxation will recall that one of the difficulties facing Pitt the Younger in the seventeen-eighties was the confusion in the public accounts. This was largely the result of the fact that receipts from taxes on selected commodities were used for specific purposes. In many cases several different levies were charged on the same commodity and the revenue from each levy earmarked for a different purpose. It can hardly be assumed, therefore, that the Founding Fathers were not acquainted with earmarking and it is probably a tribute to them that they wrote no such requirement in the organic law of our nation.

Although earmarking could be found before 1920, it was about that time that the present cycle seems to have started. Here and there one can find a few indications that the peak has been reached and that it may be on the decline. Doubtless the change in economic conditions brought about by World War I was largely responsible for the return to earmarking. The situation was especially noticeable in the rapid development of a comparatively new means of transportation. The number of motor vehicles was increasing by leaps and bounds, resulting in an enormously increased demand for better streets and highways. The mainstay of highway finance up to this time had been the taxes on property, especially real estate. During the nineteen-twenties real property values, particularly in rural areas, declined rapidly while the revenue demands of practically all functions of government increased. It seemed obvious that new sources of revenue must be found if the demands of highway users were to be satisfied. What could be better than a tax placed upon the motorist who would benefit from the improved highways? Generally, he raised no objection provided the tax which he paid to the government was used solely for his benefit.

The issue thus precipitated is often confused by the introduction of the "benefit" theory of taxation into the controversy. This is especially true in the case both of motor fuel and motor vehicle license taxes. No doubt the emphasis on "benefit" is largely the result of the attempts to make the gasoline tax palatable to the motorist. In this sense the gasoline tax and the motor vehicle license tax partake of the nature of a special assessment when used for highways; to the extent that revenues from these two sources are used for purposes other than highways they are similar to other taxes. This point can be illustrated and clarified from the situa-

tion in Ohio with respect to motor vehicles during the early part of the last decade. In 1931 the General Assembly of Ohio, in revising its tax system, especially that relating to personal property, removed motor vehicles from the property tax duplicate. At the same time it also increased the license fees on automobiles with the provision that, temporarily, a part of the revenue from this source was to be used for replacement of the revenues lost by their removal from the duplicate. Strictly, a passenger car owner purchasing a set of tags for his auto in 1932 paid for three things: (1) regulation; (2) a special assessment for the support of highways; and (3) a property tax, the revenue from which was to be used for the support of the general functions of government.

If the line of development stated above is sound, the case for and against earmarking stands or falls according to the respective merits of the arguments for and against special assessments.[5] If it is granted that some or all of the revenue from a certain source really belongs in a category similar to special assessments then it follows that those revenues should be earmarked for a specific purpose. Clearly the one who receives the benefit should pay and the payments which he makes should not be diverted to some other use. The automobile owner requires a much better road than does the owner of a horse-drawn vehicle, and this difference should be charged to him. Where benefit can be clearly allocated earmarking seems justifiable. This does not mean, however, that another tax, general in its application, should not be imposed upon the commodity. There is no good reason why a tax should not be placed upon motor fuel and earmarked for highway purposes and, at the same time, a second tax placed upon retail sales including those of motor fuel for the general functions of government.

Many instances could be enumerated where the yields from certain taxes have been earmarked and where the individual or group paying the tax receives no special benefit. Michigan, by constitutional provision, has long earmarked receipts from inheritance and certain other taxes for schools while Colorado, by the same means, guarantees that 85 per cent of the revenue from sales, use, and liquor taxes will be used for old age pensions. Ohio has, in the past, by statute, earmarked for schools the revenue from taxes on certain intangibles, cigarettes and liquid fuel. To the questions whether cigarette smokers in Ohio receive greater benefit from schooling than do cigar smokers or nonsmokers who do not pay the tax, or why the yields from these sources were dedicated to a particular activity, the only answer that can be given is that of expediency. Revenues were required and these sources were easily tapped. These requirements may have arisen out of a demand for replacement of revenue lost either (1) through a limitation of the tax rate by constitutional amendment or legislative enactment, or (2) through a narrowing of the tax base

[5] An excellent summary of the arguments for and against earmarking revenues will be found in New York State Tax Comm., *Ann. Rep.* (1937) 24-28.

by the same means, or (3) by the establishment of mandatory levies usually through property tax rates limiting the amounts available to those levels or functions of government which do not have the good fortune to hold mandatory rates, or finally (4) by a decline or delinquency in existing taxes.

The evils of earmarking in cases where "benefit" cannot be clearly shown is well brought out by the retail sales tax in Ohio. As a result of continuing delinquency of real property taxes, of the ten-mill amendment to the state constitution, and of the demand for funds to take care of relief and the schools, the need for additional revenue became imperative. A retail sales tax was enacted in 1934, effective January, 1935. The revenue from this source was earmarked for relief, aid to the aged, schools and local governments. The last two were residual claimants since they shared 40 per cent and 60 per cent, respectively, in any balance after the other claims had been met. During the second year of operation, their shares were quite large, reaching about $17,000,000 in the case of local governments and some $26,000,000 for schools. After the exemption of food by constitutional amendment these shares dropped very sharply and the recession of 1938 brought another decline. The cumulative effect of these decreases was to bring a deficit in the "School Foundation Program" of about $18,000,000. A change being absolutely necessary, in 1939 the General Assembly discontinued earmarking in large part and turned to the fixed appropriation method. While at the time this change brought little objection, local government officials have, at the present session, contended that revenue from the retail sales tax is being diverted. Obviously, the contention that diversion is taking place is a result of the increasing revenue that is being drawn from this source. To support their position these local officials point out that the sales tax was enacted to replace the losses suffered under the ten-mill amendment.

The situation in Ohio also illustrates very well the difficulties that may be encountered when a revenue source is earmarked for a specific function which must be carried on during depressions, recessions, booms and so on. If the function depends solely or very largely upon the earmarked source it should logically be possible to contract it and to expand it concurrently with the changes in the yield of the earmarked tax. But Ohio schools had to be supported regardless of the yield of the sales tax with the result that a series of recurring deficits appeared. In the case of highways the problem is somewhat different. So long as funds are available to maintain them at a definite level, however high or low, the situation is no worse. When revenues increase any surplus over maintenance can be devoted to new construction, and when this surplus decreases or ceases to exist construction can be contracted in proportion.

Diversion of Revenues and Attempts to Restrict It

It should be clear that diversion of revenues cannot take place unless prior to its existence the funds have been earmarked. During the last two decades a curious situation has developed. The increased requirements of some function of government or decreases in existing revenues have led to the tapping of new sources. This, in turn, has led to earmarking the new funds for a given function or for a given level of government, followed in the last stage by successful or unsuccessful attempts to divert to other uses the earmarked revenues. Diversion is thus an outgrowth of earmarking. Again the similarity to the special assessment becomes obvious. Legislative bodies are usually prohibited by constitutional provisions from using the yield from a special assessment for any purpose other than that specified in the petition for the assessment. Those opposed to diversion could in many cases have clarified the issue had they pointed out the similarity between earmarking and the special assessment.

There are instances where the cry of diversion seems unwarranted although the tax enacted can be condemned on other grounds. A beautiful illustration of this occurred in Ohio in 1933 when the General Assembly removed one cent from the motor fuel tax and placed a tax of one cent on liquid fuel. The revenues from this source were earmarked for public schools. The motorist and the producer and purveyor of gasoline began to cry that the gasoline tax was being diverted. Nothing could be further from the truth since this was a separate tax for a quite different purpose. They might well have asked, however, if the consumer of liquid fuel received a benefit from public schools not granted to nonconsumers. Their attack should have been from the vantage ground of the special assessment and not from that of diversion. Had the state government used for highway construction the revenue from the liquid fuel tax which was dedicated to the schools, then a true case of diversion would have been present.

The issue of diversion has been more discussed and has received more publicity in connection with motor fuel taxation than in all other connections combined. By 1929 all forty-eight states and the District of Columbia imposed a tax on gasoline. As the ensuing depression deepened, legislators and others noted that revenue from this source tended to remain constant or declined very little, while the yield from other tax sources decreased sharply or almost dried up. The inevitable reaction was to use some of this revenue to support the general functions of government. The following table is more eloquent as to the result than words could be:

TABLE IV

GASOLINE TAX REVENUES DISBURSED AND AMOUNT AND PERCENTAGE DIVERTED FOR NON-HIGHWAY PURPOSES, UNITED STATES, ANNUALLY, 1925-1939
(Thousands of dollars)

Year	Amount of Revenue: Disbursed[a]	Amount of Revenue: Diverted	Percentage Diverted
1925[b]	$146,029	$ 6,436	4
1926	187,603	3,521	2
1927	258,967	5,338	2
1928	305,234	8,346	3
1929	431,636	10,316	2
1930	494,683	15,154	3
1931	537,590	18,575	3
1932	514,139	47,570	9
1933	519,403	54,766	11
1934	565,140	88,927	16
1935	615,581	110,471	18
1936	683,074	119,408	17
1937	768,010	119,404	16
1938	769,313	121,257	16
1939	809,176	136,382	17

[a] Disbursements rather than collections are used in order to furnish a comparable base for diversion.
[b] There was probably some diversion before 1925 but no accurate information is available.
Source: Adapted from Petroleum: Facts and Figures (6th ed. 1939) 133; and Federal Works Agency, Public Roads Administration, table issued September, 1940.

Down to the time of the depression some diversion took place but it was negligible. In fact it was not until the seriousness of the economic situation came to be realized that diversion began to be practiced in earnest. Following 1931 the amounts diverted rose much more rapidly than disbursements. The peak of diversion was reached relatively in 1935, since which time diversion has shown a tendency to stabilize at about one-sixth of the total disbursements. Without doubt the Hayden-Cartwright Act, discussed in a closing paragraph, has been a stabilizing influence as well as the ratification, in several states, of constitutional amendments which prevent diversion.

The general funds of the various governmental units profited most from gasoline tax diversion in 1939, as is indicated by the table below. New York state alone accounted for almost exactly one-half going to general funds, with Pennsylvania a very poor second and Ohio a lagging third. Education was second in the gasoline bread-line but it got only about one-fourth as much as did the general funds. Texas accounted for half of the diversion to education. Relief was next in line after education, a little less than $5,000,000 behind it. The largest amount diverted to relief was $4,385,000 in Illinois, with New Jersey, California and Louisiana following in the order named.

Of the thirty states diverting some motor fuel tax revenue, Arizona was the least guilty from the point of view of the actual amount while New York was the worst offender. Twenty states and the District of Columbia placed some gasoline tax

Table V

Disposition of State Motor Fuel Tax Receipts, by State, 1939

(In thousands of dollars)

State	Highway Purposes				Non-Highway Purposes					Grand Total
	State Highways	Local Roads and Streets	Other Highwa Purposes	Total	General Funds	Relief	Education	Other	Total	
TOTAL	*$482,483*	*$188,005*	*$ 2,846*	*$673,334*	*$ 92,430*	*$ 17,489*	*$ 22,398*	*$ 4,065*	*$136,382*	*$809,716*
New England	*27,219*	*13,640*	*1,285*	*42,144*	*2,507*	*1,389*	—	*22*	*3,918*	*46,062*
Maine	5,100	602	—	5,702	—	—	—	—	—	5,702
New Hampshire	2,738	769	—	3,507	—	—	—	—	—	3,507
Vermont	1,693	962	6	2,661	—	—	—	15	15	2,676
Massachusetts	6,281	11,272	1,239	18,792	—	1,389	—	7	1,396	20,188
Rhode Island§	1,434	35	40	1,509	2,507	—	—	—	2,507	4,016
Connecticut	9,973	—	—	9,973	—	—	—	—	—	9,973
Middle Atlantic	*57,209*	*25,940*	*812*	*83,961*	*63,844*	*3,290*	*580*	*694*	*68,408*	*152,369*
New York‡	13,245	10,227	460	23,932	45,983	—	—	—	45,983	69,915
New Jersey	10,426	5,033	257	15,716	† 3,000	3,290	580	489	7,359	23,075
Pennsylvania	33,538	10,680	95	44,313	14,861	—	—	205	15,066	59,379
East North Central	*77,012*	*57,392*	*141*	*134,545*	*15,209*	*4,385*	*3,921*	—	*23,515*	*158,060*
Ohio	20,082	15,529	—	35,611	11,463	—	1,753	—	13,216	48,827
Indiana	13,565	9,288	—	22,853	1,245	—	—	—	1,245	24,098
Illinois	12,025	20,261	—	32,286	162	4,385	2,168	—	6,715	39,001
Michigan	23,129	6,550	—	29,679	5	—	—	—	5	29,684
Wisconsin	8,211	5,764	141	14,116	2,334	—	—	—	2,334	16,450
West North Central	*49,989*	*20,361*	*6*	*70,356*	*143*	*1,759*	—	—	*1,902*	*72,258*
Minnesota	12,373	6,186	—	18,559	25	—	—	—	25	18,584
Iowa	7,150	6,695	—	13,845	—	—	—	—	—	13,845
Missouri	12,045	—	—	12,045	79	—	—	—	79	12,124
North Dakota	1,840	760	—	2,600	26	—	—	—	26	2,626
South Dakota	3,434	491	6	3,931	13	—	—	—	13	3,944
Nebraska	5,903	3,772	—	9,675	—	1,759	—	—	1,759	11,434
Kansas	7,244	2,457	—	9,701	—	—	—	—	—	9,701
South Atlantic	*102,292*	*12,995*	—	*115,287*	*6,820*	—	*5,470*	*177*	*12,467*	*127,754*
Delaware	2,122	1	—	2,123	—	—	—	13	13	2,136
Maryland	6,382	4,220	—	10,602	—	—	—	—	—	10,602
District of Columbia	—	2,789	—	2,789	7	—	—	—	7	2,796
Virginia	17,221	377	—	17,598	—	—	—	13	13	17,611
West Virginia	10,394	—	—	10,394	—	—	—	—	—	10,394
North Carolina	24,430	—	—	24,430	915	—	—	113	1,028	25,458
South Carolina	10,043	2,223	—	12,266	176	—	—	—	176	12,442
Georgia	9,947	3,385	—	13,332	3,665	—	3,733	—	7,398	20,730
Florida	21,753	—	—	21,753	2,057	—	1,737	38	3,832	25,585
East South Central	*35,629*	*18,915*	*516*	*55,060*	*1,034*	—	—	*1,840*	*2,874*	*57,934*
Kentucky	12,107	1,684	—	13,791	—	—	—	—	—	13,791
Tennessee	10,359	5,389	22	15,770	1,034	—	—	1,840	2,874	18,644
Alabama	7,173	7,129	—	14,302	—	—	—	—	—	14,302
Mississippi	5,990	4,713	494	11,197	—	—	—	—	—	11,197
West South Central	*61,407*	*6,542*	—	*67,949*	*2,873*	*2,760*	*12,427*	*1,330*	*19,390*	*87,339*
Arkansas	9,086	1,309	—	10,395	—	—	—	—	—	10,395
Louisiana	10,696	—	—	10,696	2,723	2,760	1,331	1,330	8,144	18,840
Oklahoma	9,913	3,593	—	13,506	150	—	—	—	150	13,656
Texas	31,712	1,640	—	33,352	—	—	11,096	—	11,096	44,448
Mountain	*27,706*	*5,294*	—	*33,000*	—	—	—	*2*	*2*	*33,002*
Montana	4,674	—	—	4,674	—	—	—	—	—	4,674
Idaho	3,108	1,200	—	4,308	—	—	—	—	—	4,308
Wyoming	1,908	661	—	2,569	—	—	—	—	—	2,569
Colorado	5,586	2,076	—	7,662	—	—	—	—	—	7,662
New Mexico	4,272	—	—	4,272	—	—	—	—	—	4,272
Arizona	3,105	1,357	—	4,462	—	—	—	2	2	4,464
Utah	3,721	—	—	3,721	—	—	—	—	—	3,721
Nevada	1,332	—	—	1,332	—	—	—	—	—	1,332
Pacific	*44,020*	*26,926*	*86*	*71,032*	—	*3,906*	—	—	*3,906*	*74,938*
Washington	6,889	8,068	—	14,957	—	* 999	—	—	999	15,956
Oregon	8,467	1,718	86	10,271	—	—	—	—	—	10,271
California	28,664	17,140	—	45,804	—	2,907	—	—	2,907	48,711

*Includes debt service charges on emergency relief bond issues, prorated in proportion to use of proceeds for state highways, local roads and streets, and non-highway purposes.

†Originally appropriated for relief but later transferred by legislative action to the state general fund.

‡Appropriations for highway purposes out of the state general fund have been credited against payments of motor-fuel tax and motor-vehicle revenues to the general fund and prorated in proportion to net receipts from highway user taxes not otherwise dedicated.

§Expenditures for highway purposes have been credited against payments of motor-fuel tax and motor-vehicle revenues to the state general fund and prorated in proportion to net receipts from highway user taxes not otherwise dedicated.

Source: Federal Works Agency, Public Roads Administration, table issued September, 1940.

money in the general funds of the state or local governments. Only seven states singled out the motorist to help support relief. The same number of states called upon the purchaser of motor fuel to do his bit to keep our school fires burning.

The diversion of gasoline tax revenues is almost negligible in ten of the states, including the District of Columbia which follows the practice. These are, besides the District, Arizona, Delaware, Michigan, Minnesota, Missouri, North Dakota, South Dakota, Vermont, and Virginia. In fact not one of these states diverts as much as one per cent. The extent of the practice among the twenty remaining states which follow it is indicated in the table which follows:

TABLE VI

STATES USING ONE PER CENT OR MORE OF MOTOR FUEL TAX RECEIPTS FOR NON-HIGHWAY PURPOSES, 1939

Under 10%	*10% but Under 20%*	*20% but Under 30%*	*30% but Under 40%*	*40% but Under 50%*	*50% but Under 60%*	*60% but Under 70%*
California	Florida	Ohio	Georgia	Louisiana	—	New York
Indiana	Illinois	Pennsylvania	New Jersey	—	—	Rhode Island
Massachusetts	Nebraska	Texas				
North Carolina	Tennessee					
Oklahoma	Wisconsin					
South Carolina						
Washington						
7	5	3	2	1		2

Source: Table V.

In view of the conditions under which motor fuel taxes were brought into existence, it is not surprising that any attempt to use the revenues from this source for non-highway purposes would be resisted. As diversion increased attempts were made to prevent it by one means or another. Several states have gone so far as to amend their constitutions in this respect. These states, with dates of ratification, are: California (1938), Colorado (1934), Idaho (1940), Kansas (1928), Michigan (1938), Minnesota (1928, motor fuel revenue, and 1932, motor vehicle license revenue), Missouri (1928), Nevada (1940), New Hampshire (1938), North Dakota (1940) and South Dakota (1940).[6] In 1939, "Iowa passed a legislative resolution prohibiting the diversion of gas and motor fees from road uses. Anti-diversion constitutional amendments were proposed without success in Kentucky, New Jersey, Rhode Island, and Virginia."[7] Such rejection by the voters of proposals for amending state constitutions is in the right direction since earmarking and diversion should be subjects left for the consideration of the state legislature.

In the absence of specific constitutional prohibition against diversion, recourse has been had to all manner of express or implied constitutional provisions in an effort to achieve the same result. Ready-made for the occasion, seemingly, was the doctrine that one group cannot be taxed for the benefit of another. This doctrine, the basis for which becomes clearer the narrower the tax base and the more distinct the group

[6] Letter from C. A. Curtis, Acting Commissioner of Public Roads, March 31, 1941.

[7] 4 THE BOOK OF THE STATES, 1941-1942 (1941) 108.

to be aided by the expenditure of the tax monies, is sometimes conceived of as a form or special phase of the more familiar public purpose rule,[8] at other times as an application of the equal protection principle[9] or an offshoot of due process independent of the public purpose concept.[10] But despite the appropriateness of such a constitutional doctrine to establishment of a bar to diversion of tax monies, it has seldom been advanced by counsel in litigating gasoline-tax, or indeed any other form of consumption-tax diversion.[11] The explanation probably lies in the fact that courts are chary of a doctrine which if consistently applied would throw into chaos the tax systems of the states and Federal Government. Although *United States v. Butler*[12] is difficult to comprehend unless the Court there intended to apply this limitation to federal taxing and spending powers,[13] neither before[14] nor since[15] the time of that decision has success crowned efforts of counsel to secure the Court's judicial disapproval of state action on the ground that it imposes on a particular class a fiscal burden beneficially common to others as well. State reports, however, are not devoid of tangible evidence of successful resort to this doctrine.[16]

While gasoline tax funds are not likely to be judicially recognized, because of their source, as earmarked for highway purposes, some success has attended the challenge of diversion on other grounds. If the purpose for which the revenues are diverted can be labeled as "private," as was successfully done in *In re Opinion of the*

[8] See, *e.g.*, 1 COOLEY, TAXATION (4th ed. 1924) 650; Haines, *Judicial Review of the Acts of Congress and the Need for Constitutional Reform* (1936) 45 YALE L. J. 816, 829. The latter reference speaks of the doctrine as being "a *new* form of the public purpose principle" read into constitutional law by United States v. Butler, 297 U. S. 1 (1935). In this it is in error because the principle can be traced back about as far as can that of public purpose.

[9] Note (1936) 45 YALE L. J. 729, 730; Lowry v. City of Clarksdale, 154 Miss. 755, 122 So. 195 (1929). Or of the analogous but more strict uniformity principle of some state constitutions. Gilman v. City of Sheboygan, 2 Bl. 510 (U. S. 1862).

[10] See Kelly v. Pittsburgh, 104 U. S. 78 (1881); State v. Lafayette Fire Ins. Co., 134 La. 78, 63 So. 630 (1913) (fundamental principle of taxation by free governments).

The limitation is usually keyed to the due process clause where the claim is, as in *Kelly v. Pittsburgh* and *State v. Lafayette Fire Ins. Co.*, both *supra*, that those taxed can derive no benefit whatever from the exaction, all benefit going to others; to the equal protection clause where, as in the *Lowry* case, *supra* note 9, the tax group claims that the exaction is disproportionate to the benefit, which others equally enjoy.

[11] Search indicates that the issue was raised in *In re* Opinion of the Justices, 59 S. D. 469, 240 N. W. 600 (1932) (motor vehicle fuel taxes—feed and loans to distressed live stock raisers); Stults Eagle Drug Co. v. Luke, 48 Ariz. 467, 62 P. (2d) 1126 (1936) (luxury taxes on cosmetics, playing cards, tobacco products, *etc.*—unemployment relief). In both cases the contention was unavailing.

[12] *Supra* note 8.

[13] See Grant, *Commerce, Production, and the Fiscal Powers of Congress* (1936) 45 YALE L. J. 751, 766-768, and 991, 1009-1010.

[14] County of Mobile v. Kimball, 102 U. S. 691 (1880), where the financial burden of improving Mobile harbor, of distinct commercial value to the entire State of Alabama, was placed upon the County of Mobile.

[15] New York Rapid Transit Corp. v. City of New York, 303 U. S. 573, 584-587 (1938), where New York City's unemployment relief burden was cast upon local utilities.

[16] See, *e.g.*, Lowry v. City of Clarksdale, *supra* note 9; Continental Ins. Co. v. Smrha, 131 Neb. 791, 270 N. W. 122 (1936); City of Louisville v. Aetna Fire Ins. Co., 284 Ky. 154, 143 S. W. (2d) 1074 (1940), all invalidating as violative of the equal protection guaranty the imposition upon insurance companies of taxes for the support of firemen's pension funds. *Contra* in attitude is *In re* Hunter's Estate, 97 Colo. 279, 49 P. (2d) 1009 (1935), two judges dissenting, sustaining additional motor vehicle registration, inheritance and incorporation fees for the financing of unemployment relief.

Justices,[17] the issue has been held within justiciable limits which the courts are willing to recognize by virtue of the established character of the principle that taxes must be for a public purpose.[18] Use of such funds for relief purposes was stopped in *Smithberger v. Banning*[19] on the ground that the appropriation carried an unconstitutional delegation of legislative powers. Invoked also, but without success, have been the express state constitutional provisions fixing maximum debt limits,[20] forbidding impairment of the obligation of contract,[21] and voiding tax legislation which embraces more than one subject or one not expressed in the title.[22] Other litigation, however, indicates a fair amount of judicial receptiveness to challenges of gasoline tax diversion that are couched in terms of the common constitutional clause requiring that every taxing act distinctly state the object of the levy and expressly or inferentially prohibiting use of the monies for any other purpose. Not only will such a clause checkmate diversion of funds at hand and appropriated;[23] recent South Carolina decisions limit the assumed power[24] of succeeding legislatures to establish new uses for the money raised. The South Carolina court takes the position[25] that inasmuch as the object stated in the state's gasoline tax levies is furtherance of a highway program, it does not suffice for the legislature merely to redirect the funds derived therefrom without altering the basic purpose therein expressed.[26]

Nationally, resistance to diversion has taken the form of a Congressional enactment of 1934, the Hayden-Cartwright Act, the pronounced effect of which on stabilization of the diversion upswing has already been noted. The pertinent section of this statute is worth quoting:[27]

Since it is unfair and unjust to tax motor vehicle transportation unless the proceeds of such taxation are applied to the construction, improvement, or maintenance of highways, after June 30, 1935, Federal aid for highway construction shall be extended only to those states that use at least the amounts now provided by law for such purposes in each state from state motor vehicle registration fees, licenses, gasoline taxes, and other special taxes on motor vehicle owners and operators of all kinds for the construction, improvement,

[17] *Supra* note 11.

[18] See the discussion in Note (1936) 45 YALE L. J. 729, 730.

[19] 129 Neb. 651, 262 N. W. 492 (1935).

[20] State *ex rel.* v. Martin, 173 Wash. 249, 23 P. (2d) 1 (1936) (diversion for unemployment relief).

[21] Michaels v. Barrett, 355 Ill. 175, 188 N. E. 921 (1934) (same).

[22] *Ibid.*

[23] White Eagle Oil Co. v. Gunderson, 48 S. D. 608, 205 N. W. 614 (1925) (diversion for state enterprise); *In re* Opinion of the Justices, *supra* note 11.

[24] See Michaels v. Barrett, *supra* note 21.

[25] State *ex rel.* v. Osborne, 193 S. C. 158, 7 S. E. (2d) 526 (1940), *id.* 195 S. C. 295, 11 S. E. (2d) 260 (1940) (diversion for general state expenses).

[26] Buttressing this view in the court's mind was the less usual South Carolina constitutional provision which specifies that the legislature shall provide for state expenses and deficits—the object for which diversion was here attempted—by the levy of a special tax and not by mere appropriation of monies derived from prior taxation.

[27] 48 STAT. 995, 23 U. S. C. §55 (1934). Additional encouragement, over and above the Hayden-Cartwright Act, of limitation of the non-highway use of motor fuel tax collections is given by another section of the Federal Highway Act which provides that under certain conditions the matching requirements for federal aid are suspended. One of the conditions is that all taxes on motor vehicle transportation be used for highway purposes. 52 STAT. 633, §1c (1938), 54 STAT. — (1940), 23 U. S. C. A. §10(b) (1940).

and maintenance of highways and administrative expenses in connection therewith, including the retirement of bonds for the payment of which such revenues have been pledged, and for no other purposes, under such regulations as the Secretary of Agriculture shall promulgate from time to time: Provided, that in no case shall the provisions of this section operate to deprive any state of more than one-third of the amount to which that state would be entitled under any apportionment hereafter made, for the fiscal year for which the apportionment is made.

Three states have been penalized under the provisions of this section of the act. In 1937 New Jersey was deprived of $250,000 of federal aid funds and a year later (1938) Massachusetts had $472,862 of such funds denied her. In 1940 a penalty of $504,074 was placed on Georgia.[28] It is extremely difficult to justify federal enactment of such a penalty for the diversion of state gasoline tax monies. Federal aid should be granted outright or on the basis of matching with state funds, or withdrawn altogether. One cannot but agree with the Tax Policy League that "this seems the most unwarranted bit of interference with state finances upon the part of Congress that has been exhibited by that body."[29]

CONCLUSION

In conclusion it must be said that the great variety of methods now in use in distributing the revenues from consumer taxes indicates there is no single, simple formula which will meet all situations. No doubt the method adopted has often been more the result of political expediency and local condition than of sound theory. Perhaps the latter does not now exist; certainly the question of allocation merits serious and continued investigation. Undoubtedly the earmarking of receipts from certain tax sources for specific purposes can be justified, but its proponents are very likely to overstep the bounds and to forget that its use should be very severely restricted. Benefit should be the guide. This should not preclude, for example, subjecting retail sales of gasoline to the sales tax, and using the revenues therefrom for general purposes although gasoline may be already taxed for the support of highways. Once the yield from a tax is earmarked it should not be diverted. There seems to be little tendency for diversion to increase relatively, although the actual amount in dollars and cents may show either increases or decreases depending upon economic conditions.

[28] Letter from C. A. Curtis, Acting Commissioner of Public Roads, March 31, 1941.

[29] (April, 1938) 5 TAX POLICY No. 5. See also Magill, *Trends in Public Finance* (1940) 18 TAXES 3, 6; Crawford, *The Gasoline Tax—Its Use and Abuse* (1940) 18 *id.* 83, 84-85.

JURISDICTIONAL AND INTERSTATE COMMERCE PROBLEMS IN THE IMPOSITION OF EXCISES ON SALES

Joseph P. McNamara*

The popular conception of the tax assessor as being as confidently relentless as a dentist, drill in hand, has always had its counterpart; at the mention of interstate commerce the tax gatherer has looked and acted like a hound that has been chased by rabbits. The reason? It was not altogether a mirroring of "the action of States . . . looking with jealous eye upon the freedom of interstate commerce";[1] rather it had its source in the fact that the economic results of adjudicated cases and the doctrinal pronouncements accompanying them did not converge. Distinctions between "direct" and "indirect" burdens upon interstate commerce were the barren results of sterile logic rather than practical effect bound up with the taxes judicially reviewed. The results, viewed economic-wise, revealed a broad, sure highway, while the map of the courts' mind revealed by the decisions indicated either no road, not even a path, or detours, dead-ends, quagmires, and missing bridges.

The Constitutional Situation Prior to the *Berwind-White* Decision

The commerce clause concept as developed prior to 1930 placed emphasis upon individual rights. Since the depression this emphasis has shifted to an approach based upon social consciousness. Such divergent first premises could not fail to lead to a revolutionary realignment of the very principles applicable to state taxation under the commerce clause. Perhaps the foregoing observation oversimplifies recent developments. There is also an economic aspect: during most of the life of the Republic its states have relied mainly upon property taxation for the revenues which nourished them. In a property tax system, the rule that no state could tax interstate commerce was not, functionally, a serious limitation. But, latterly, sales taxes and taxes measured by gross receipts, fostered by necessity and by the general urbanization of society, have grown to be good providers to many of the states and their political subdivisions.[2] Such a tax system finds the old formulae a serious hindrance, both from a revenue standpoint and from the standpoint of economic results. They aggravated the competitive struggle, for the old doctrines fathered discrimination against local businessmen, who felt the bite of a tax from which were exempted

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[1] See Hughes, C. J., dissenting in McGoldrick v. Berwind-White Coal Mining Co., 309 U. S. 33, 66 (1940).

[2] Haig and Shoup, The Sales Tax in the American States (1934) 2 *et seq.*, 37-38, 100-101; Pierce, *The Place of Consumers' Excises in the Tax System, supra* this issue.

active competitors who solicited by mail or through drummers.[3] These observations invite a review of the situation as it existed prior to the recent New York City sales tax cases.

During the decade just passed, the state of the law of taxation in its relation to the commerce clause seemed all sail and no anchor. That decade had been preceded by a stretch of three decades or more during which it seemed definitely established that no state might tax an interstate sale.[4] No less than nineteen state taxing statutes and municipal ordinances[5] were invalidated because their grasp was deemed a restraining burden upon the occupation of selling goods prior to the interstate transportation necessary to effect the delivery of those goods to the purchaser. There can be no doubt that the Court was profoundly influenced in all of these cases by the practical consideration that the type of tax involved, *i.e.*, a license, usually of a fixed amount, was really a device to discriminate actively against interstate commerce and to place it upon a disadvantageously competitive footing with local commerce. The rule thus appeared fixed, and, if the pronouncements were to be believed, unchangeable. To be sure a variation existed, for at the same time the Court recognized that gross receipts could properly be utilized as the measure of a tax if the appearance of placing the tax "on sales," as such, could be avoided, and if the avowed subject matter of the exaction were found to be manufacture,[6] extraction,[7] or severence.[8] In such instances, the tax was constitutionally unassailable, despite the fact that the measure was the sale price of the property which, regardless of the name given to the tax, was fairly certain to be affected by its imposition.

As demands for state revenue brought forth the gasoline tax, and later its logical extension, the general sales tax, state courts,[9] tax collectors,[10] and the United States

[3] Henneford v. Silas Mason Co., 300 U. S. 577 (1937).

[4] *I.e.*, a sale which required delivery by transportation across state lines as an integral part of the performance of a sales contract entered into prior to the initiation of such transportation.

[5] From 1887 to 1925: Robbins v. Shelby County Taxing District, 120 U. S. 489 (1887); Carson v. Maryland, 120 U. S. 502 (1887); Asher v. Texas, 128 U. S. 129 (1888); Stoutenburgh v. Hennick, 129 U. S. 141 (1889); Brennan v. Titusville, 153 U. S. 289 (1894); Stockard v. Morgan, 185 U. S. 27 (1902); Caldwell v. North Carolina, 187 U. S. 622 (1903); Norfolk & Western Ry. Co. v. Sims, 191 U. S. 441 (1903); Rearick v. Pennsylvania, 203 U. S. 507 (1906); Dozier v. Alabama, 218 U. S. 124 (1910); Crenshaw v. Arkansas, 227 U. S. 389 (1913); Rogers v. Arkansas, 227 U. S. 401 (1913); Stewart v. Michigan, 232 U. S. 665 (1914); Heyman v. Hays, 236 U. S. 178 (1915); Davis v. Virginia, 236 U. S. 697 (1915); Western Oil Refining Co. v. Lipscomb, 244 U. S. 346 (1917); Cheney Bros. Co. v. Massachusetts, 246 U. S. 147 (1918); Alpha Portland Cement Co. v. Massachusetts, 268 U. S. 203 (1925); Real Silk Hosiery Mills v. Portland, 268 U. S. 325 (1925).

[6] American Mfg. Co. v. City of St. Louis, 250 U. S. 459 (1919); Utah Power & Light Co. v. Pfost, 286 U. S. 165 (1932).

[7] Oliver Iron Mining Co. v. Lord, 262 U. S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U. S. 245 (1922); Hope Natural Gas Co. v. Hall, 274 U. S. 284 (1927).

[8] Lacoste v. Dep't of Conservation, 263 U. S. 545 (1924); Federal Compress Co. v. McLean, 291 U. S. 17 (1934). "In plain economic fact the states can tax interstate commerce if they go about it in the right way." Powell, *Contemporary Commerce Clause Controversies Over State Taxation* (1928) 78 U. OF PA. L. REV. 773, 774.

[9] Montgomery Ward & Co. v. Fry, 227 Mich. 260, 269 N. W. 166 (1936); National Cash Register Co. v. Taylor, 276 N. Y. 208, 11 N. E. (2d) 881 (1937), *cert. denied sub nom.* McGoldrick v. National Cash Register Co., 303 U. S. 656 (1938); Compagnie Generale Transatlantique v. McGoldrick, 274 N. Y. 192, 18 N. E. (2d) 28 (1938).

[10] HAIG AND SHOUP, *op. cit. supra* note 2, at 83; Jacoby, *Conflicting Interpretations of Retail Sales Tax Laws* (1934) 2 U. OF CHI. L. REV. 78, 96.

Supreme Court by *dicta,*[11] assumed that the by-then-familiar formula would also shield sales in which the order preceded delivery across state lines. In fact the Supreme Court held that no tax could constitutionally be placed upon the first sale of petroleum products in the original package after interstate transportation had ceased.[12] In tabloid, this was the background for the pronouncements that interstate commerce could not be taxed by the states at all.

An erosion of the established doctrine began, however, with statements that the states could tax so long as they did not "burden" commerce "as such." *Sonneborn Brothers v. Cureton*[13] represented one turning point, although Formula's face was saved by the *dicta* that sales made prior to interstate shipment would be relieved of the tax because "such transactions are interstate commerce in its essence." In reality, the Court's decision appears to have been bottomed upon the consideration that the result afforded equal competitive opportunities to local and interstate commerce alike.

Viewed from the standpoint of the equality achieved by sustaining the tax, or, contrariwise, from the standpoint of the disastrous inequalities which would have been called into operation if the tax were declared invalid, it would seem that the same result would have been reached by the Court whether the order preceded the interstate shipment or was one for property in the original package after shipment across the state line had ceased. This consideration appears to have been the forerunner of the ruling in *Gregg Dyeing Co. v. Query,*[14] in which a tax equal in amount to the tax on the sale of gasoline was imposed upon the storage within the state of products on which no state gasoline tax had previously been paid. Here was a tax aimed directly at goods coming into a state through interstate channels precisely because of such interstate pedigree. The tax was sustained. Equality of competition between local and interstate competition provided the key.[15]

The critical test, in so far as the sale of gasoline was the chosen subject matter of the excise, came in *Eastern Air Transport v. South Carolina Tax Comm.,*[16] which sustained a tax imposed upon the sale of gasoline destined exclusively for use as the propelling factor of transportation across state lines. At the same term of court, in *Nashville, Chattanooga & St. Louis Ry. v. Wallace,*[17] a tax on the storage within the taxing state of out-of-state-origin gasoline, and its withdrawal for use to generate the energy necessary to bring about interstate transportation, was sustained.[18]

The next step in the evolution of the law was taken with reference to "use" taxes when in 1934 the duty imposed by a state statute upon a refiner or wholesaler to collect the gasoline tax from retailers was sustained, in spite of the consideration that

[11] Sonneborn Bros. v. Cureton, 262 U. S. 506, 515 (1923).

[12] Standard Oil Co. v. Graves, 249 U. S. 389 (1919); Askren v. Continental Oil Co., 252 U. S. 444 (1920); Bowman v. Continental Oil Co., 256 U. S. 642 (1921); Phipps v. Cleveland Refining Co., 261 U. S. 449 (1923).

[13] *Supra* note 11.

[14] 286 U. S. 472 (1932).

[15] In sustaining the tax the Court observed that the taxpayer paid "precisely the same amount per gallon as other consumers within the state. . . ." See also Bowman v. Continental Oil Co., *supra* note 12, at 648-649 (1921); Hart Refineries v. Harmon, 278 U. S. 499, 501 (1929).

[16] 285 U. S. 147 (1932).

[17] 288 U. S. 249 (1933).

[18] To the same effect was Edelman v. Boeing Air Transport, 289 U. S. 249 (1933).

the gasoline was, pursuant to a prior order, to be shipped across state lines to effect delivery to the retailer.[19]

Against this background, the Supreme Court in 1935 announced its holding in *Wiloil Corp. v. Pennsylvania*.[20] This pronouncement, variously interpreted, resulted in the origin of the "facilities" test in tax administrative circles.[21] The Court found that interstate transportation, although actually occurring in fulfillment of a prior sale, was not "required or contemplated," and for that reason treated the sale in the same manner as though no interstate shipment had occurred. This definitely, albeit subtly, eroded the ancient maxim that a state could not tax an interstate sale, and modified in a very important particular *Robbins v. Shelby County Taxing District*.[22] Significantly, this erosion preserved equality of competition in the buyer's state. Unmistakably the decision attached importance to the factor that interstate transportation was not a condition to the completion of the contract, but that, in so far as the buyer in the taxing state was concerned, it was incidental. The language of the opinion is that[23] "As interstate transportation was not required or contemplated, it may be deemed as merely incidental."

The practical considerations which underlay the *Wiloil* decision and the sweep of the opinions leading up to it, culminated, by logical progression, in *Henneford v. Silas Mason Co.*[24] The use tax of the state of Washington, there approved, was imposed upon use within the state of goods purchased at retail in all instances where an equivalent retail sales tax had not been paid, either in Washington or in some other state. In effect, this accomplished all that could have been achieved by extending the general sales tax to all sales involving a Washington consumer as the purchaser, regardless of whether the sales were within the territorial boundaries of the taxing state, or were extrastate.

The thread of preservation of equality of competition between local and interstate commerce, apparent in the results reached in all of the cases heretofore noted, was also present in *Western Live Stock v. Bureau of Revenue*,[25] which sustained the New Mexico business and occupations tax as measured by gross receipts derived from the performance of advertising contracts. But the *Western Live Stock* opinion presented a new approach to the problem that foreshadowed the criterion upon which subse-

[19] Monamotor Oil Co. v. Johnson, 292 U. S. 86 (1934).

[20] 294 U. S. 169 (1935).

[21] The facilities test is to the effect that if the taxpayer is possessed of goods within the boundaries of the taxing state similar to those ordered, but chooses to complete the sale by a shipment to the purchaser from a second state, the transportation not being essential to the completion of the sale, the fact of the transportation across state lines will not bar the imposition of a tax by the state into which the goods are shipped. This phase of a practical tax problem seems to have escaped the notice of the courts, except perhaps in Sears, Roebuck & Co. v. McGoldrick, 279 N. Y. 184, 18 N. E. (2d) 25 (1938), *reargument denied*, 280 N. Y. 570, 20 N. E. (2d) 18 (1939). But observe that the same result was reached in Graybar Electric Co. v. Curry, 238 Ala. 116, 189 So. 186 (1939), *aff'd per curiam*, 308 U. S. 513 (1939).

[22] 120 U. S. 489 (1887). Note also the Court's discussion of the *Robbins* case in McGoldrick v. Berwind-White Coal Mining Co., *supra* note 1, at 57.

[23] *Supra* note 20, at 175. Later, in Graybar Electric Co. v. Curry, *supra* note 21, a tax was sustained even though the contract of sale plainly contemplated an interstate shipment. See also, McGoldrick v. Berwind-White Coal Mining Co., *supra* note 1, discussed *infra*.

[24] *Supra* note 3.

[25] 303 U. S. 250 (1938).

quent cases have been decided. This was that state taxes measured by gross receipts are to be sustained when they do not result[26] in "cumulative burdens not imposed on local commerce" "merely because interstate commerce is being done." The language utilized was:[27]

> The vice characteristic of those [taxes burdening commerce between the states] is that they have placed on the commerce burdens of such nature as to be capable, in point of substance, of being imposed . . . or added to . . . with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce.

Correspondingly, in *Adams Manufacturing Co. v. Storen,*[28] the "risk of a double tax burden to which intrastate commerce is not exposed" proved the basis for invalidating an assessment made under the Indiana Gross Income Tax Act. There the tax was imposed on the goods by the state of origin, and was measured by the gross receipts derived from a sale which required the goods to be transported across state lines to the purchaser. Similarly, the multiple tax test was applied, this time to sustain the tax, on the generation of power used to induce the interstate transportation of oil through a pipe line.[29] And in 1939, the risk of multiple taxation to which local commerce was not exposed formed the test which in *Gwin, White & Prince, Inc. v. Henneford*[30] resulted in the nullification of the Washington state tax measured by gross receipts, where the sales activities productive of the tax base were necessarily extrastate and interstate in character.

THE NEW YORK CITY SALES TAX CASES

On January 29, 1940, Mr. Justice Stone read the prevailing opinion in *McGoldrick v. Berwind-White Coal Mining Co.,*[31] while Mr. Chief Justice Hughes delivered a dissent in which two colleagues concurred. Upheld was a sales tax imposed by a city in the state of delivery with reference to personal property shipped from another state to consummate a sales agreement entered into prior to the commencement of the transportation. The seller maintained within New York City sales offices at which the orders for the coal were received. The coal was then mined in Pennsylvania, shipped and delivered in the seller's barges to the purchaser at water's edge in New York City. Under the old dispensation, here was a factual situation which would have spelled tax immunization. But the tax was upheld. Evidently the canons of

[26] The actual result in the precise case before the Court probably was not intended to be the sole test. Later applications of the rule indicate that danger of cumulative burdens was deemed sufficient to cause the Court to invoke the prohibition. Adams Mfg. Co. v. Storen, 304 U. S. 307 (1938); Gwin, White & Prince, Inc. v. Henneford, 305 U. S. 434 (1939). When this test was first announced it seemed that it would have been better to have restricted its application to instances wherein the cumulative burden was present or at least actually and immediately threatened. *McGoldrick v. Berwind-White Coal Mining Co.,* and other New York City sales tax cases indicate that practicability may well be served in another manner, that is, by assigning the taxing prerogative exclusively to the purchaser's state.

[27] Western Live Stock v. Bureau of Revenue, *supra* note 25, at 255-256.

[28] *Supra* note 26.

[29] Coverdale v. Arkansas-Louisiana Pipe Line Co., 303 U. S. 604, 613 (1938).

[30] *Supra* note 26.

[31] *Supra* note 1.

practicability referred to by Mr. Justice Stone in *Western Live Stock v. Bureau of Revenue*[32] came into full flower in the New York City sales tax cases.

Because comment upon the leading decision in the *Berwind-White* case has been so widespread, the results in three companion cases decided by the Court on the same day have suffered relative obscurity. In the first of these, *McGoldrick v. Felt & Tarrant Manufacturing Co.*,[33] a taxpayer solicited in New York City orders for comptometers which, upon the approval of the orders at the principal office of the company in Chicago, Illinois, were shipped, invoiced to the purchaser, to the seller's New York City agent, who delivered them to the purchaser after inspection and adjustment. The New York City sales tax was upheld with reference to such transaction. In the same opinion the Court dealt with the case of *McGoldrick v. A. H. Du Grenier, Inc., et al.*[34] where an exclusive sales agent solicited orders in New York City for vending machines manufactured by the taxpayer, a Massachusetts corporation. The seller, upon approval of the orders, sent the machines by common carrier direct to the buyer in New York City, who paid the freight. Taxation by New York of this type of transaction was also sustained.

Perhaps the most significant of all the New York City sales tax cases decided on that day is that of *Jagels, "A Fuel Corporation" v. Taylor*,[35] a *per curiam* memorandum decision upon authority of the other decisions which have just been discussed. The sales about which the controversy in the *Jagels* case arose and upon which the tax had been assessed fell within three classes: In the first were orders received by telephone at the petitioner's New York office, which the petitioner telephoned to its New Jersey office, where, upon credit approval, they were accepted and delivery made to the consumer in New York from a New Jersey coal yard. In the second class, the order was telephoned direct to New Jersey by the customer, followed by a confirmatory written order, and delivery was made from the New Jersey yard to the customer in New York. In the third class, a written order was sent by the purchaser in New York to the New Jersey office, and delivery was made from the New Jersey yard to the customer in New York. In all three classes, the customer was billed from the New Jersey office, and payment was made to that office. The important thing about the *Jagels* case is that the tax was sustained with reference to all three classes of sales despite the fact that, in the third class, the sale was not made through the resident office at all but resulted from a mail order.

All of the New York City sales tax cases turn upon the multiple tax doctrine which, in effect, permits the state in which delivery of the property is made to impose the tax rather than the state from which the property is shipped. This choice is made because where the state of delivery is permitted to tax, the burden is certain to be equal to, but no greater than that borne by domestic commerce. The Court in the *Adams Manufacturing Co.* case had already observed that if the shipping state and the state in which delivery was effected were permitted to tax the same transaction, there would be one more tax on such a sale than there would be upon purely local

[32] *Supra* note 25. [33] 309 U. S. 70 (1940). [34] *Ibid.*
[35] 309 U. S. 619 (1940), *aff'g* 280 N. Y. 766, 21 N. E. (2d) 526 (1939).

sales.[36] But while the *Adams* case had invalidated a tax imposed by the state of origin, there had as yet been no actual decision pointing out that the state of destination or delivery would be permitted to tax a sale where the order preceded the delivery of the goods across a state boundary. The majority opinion in the *Berwind-White* case, in dealing with the familiar doctrine which had distinguished between sales where the order for the goods was received and accepted before the transportation from across state lines was initiated and those where it was made after, utilized the following language:[37]

> But we think that this distinction is without the support of reason or authority. A very large part, if not most of the merchandise sold in New York City is shipped interstate to that market. In the case of products like cotton, citrus fruits and coal, not to mention many others which are consumed there in vast quantities, all have crossed the state line to seek a market, whether in fulfillment of a contract or not. That is equally the case with other goods sent from without the state to the New York market whether they are brought into competition with like goods produced within the state or not. We are unable to say that the present tax laid generally upon all sales to consumers within the state, subjects the commerce involved where the goods sold are brought from other states to any greater burden or affects it any more in any economic or practical way, whether the purchase order or contract precedes or follows the interstate shipment. Since the tax applies only if a sale is made, and in either case the object of interstate shipment is a sale at destination, the deterrent effect of the tax would seem to be the same on both. Restriction of the scope of the commerce clause so as to prevent recourse to it as a means of curtailing state power seems as salutory in the one case as in the other.

Is "Imposition" the Magic Word?

Since the announcement of the *Berwind-White* decision, some have attempted to minimize its effect by asserting that the rule announced is only applicable where the taxing enactment formally "imposes the tax upon the purchaser." A provision of the New York City taxing ordinance directing that the tax "shall be paid by the purchaser to the vendor, for and on account of the City of New York," lends some color to the hypothesis that sales taxes or gross receipts taxes formally levied upon the vendor will not participate in the enlightened attitude which blacks out the former discrimination in favor of interstate commerce. The recent decision affirming the power of a state to tax the transaction of renting safe deposit boxes, despite the fact that the lessor was a national bank, will probably be cited in support of this restrictive hypothesis, since there the Court mentioned that the tax was formally "imposed" upon the lessee.[38] What would be overlooked in drawing such an analogy is this: The reason for the rule in the *Bedford* case is that it is not enough that the tax be non-discriminatory. National banks, as such, may be taxed by the states only in the manner that Congress prescribes,[39] whereas, in the *Berwind-White* case, a non-discriminatory tax on interstate commerce was upheld. Thus in the *Bedford* case, because an entirely different rule was applicable, it was necessary to show that the tax was not on the bank. In addition, it should be noted that both the economic thrust

[36] *Supra* note 26, at 311.
[37] *Supra* note 1, at 54.
[38] Colorado National Bank v. Bedford, 310 U. S. 41 (1940).
[39] REV. STAT. §5219 (1875), 12 U. S. C. §548 (1934).

and the technical requirement with reference to the imposition of the tax led to the result reached.

It would appear that such attempts to limit the Berwind-White rule are destined for disappointment. Practicality is the essence of both the pronouncement and the results achieved in the case itself. The strength of the analogy in economic impact between the New York City sales tax and the use taxes which the Court has hitherto held valid indicates clearly that out-of-pocket realities, rather than form, are the controlling factors. In the use tax cases, the vendor is responsible for the collection of the taxes; as far as actual results are concerned, therefore, there is no substantial difference between these excises. The effect upon commerce is identical in both cases. The minority who dissented in the *Berwind-White* case, thereby objecting to the imposition of the sales tax, had previously approved of the incidence of the use tax. Had a substantial economic difference existed between the results of a sales tax and a use tax, the minority would have demonstrated it. Significantly, they did not attempt such a task. The rule permitting the state of entrance to impose a sales tax is not likely to be restricted to statutes which name the purchaser as the person from whom the tax is to be collected.

Must Both Order and Delivery Occur Within the Taxing State?

In the *Berwind-White* case the receipt of the order, its acceptance, and the delivery of the thing sold, all occurred within the taxing jurisdiction. Since many other states having sales taxes are so situated geographically that only the delivery takes place within the taxing jurisdiction, the question has been presented whether this aspect of the transaction affords sufficient basis to tax.

The *Berwind-White* decision does not go that far. But from its companion cases[40] the deduction is unmistakable that the place at which the contract is approved or made was considered by the Court as being immaterial. In the *Felt & Tarrant* case the sales contract was approved in Illinois, in the *Du Grenier* case, in Massachusetts, while in the *Jagels* case it was approved in New Jersey. From a legal standpoint such sales contracts are considered as being made, respectively, in Illinois, Massachusetts, and New Jersey.

From a practical standpoint, the place of making the agreement of sale is unimportant. There is no greater danger of pyramiding tax burdens where the approval of the order is an extrastate activity, than where approval to sales is locally indicated. No cumulative tax burden will result where only the delivery occurs within the taxing jurisdiction, if the power to tax is limited to the jurisdiction in which delivery is accomplished. It seems safe, therefore, to predict that sales taxes in states of entrance will be sustained regardless of the locale chosen at which to consummate the agreement of sale.

Since the *Berwind-White* decision was announced, Illinois, Virginia, Washington, Utah, and Kansas have promulgated new regulations. Newspapers have character-

[40] McGoldrick v. Felt & Tarrant Mfg. Co., McGoldrick v. A. H. Du Grenier, Inc., *supra* notes 33 and 34; Jagels, "A Fuel Corporation" v. Taylor, *supra* note 35.

ized the tax imposed under such broadened regulations as a "delivery tax." Whether this is so is a debatable question. Those who are of the "delivery-is-the-only-essential" school rely upon a statement of the majority describing the tax as[41]

> . . . conditioned upon events occurring within the state, either *transfer* of title *or possession* of the purchased property, or an agreement within the state "consummated" there, for the transfer of title, or possession;

and also upon the dissent's characterization of the tax as one on delivery:[42]

> It is urged that there is a taxable event within the state. That event is said to be the delivery of the coal. . . . If, because of the *delivery* in New York, that State can tax the gross receipts from the sale. . . .

They also point to the result in the *Jagels* case and to the fact that no discrimination results from such a tax; that realities and practical consequences are its only fruits.

Those who believe that some local activity, in addition to mere delivery, must exist before the state of destination may tax, point out that the statements of the *Berwind-White* majority, quoted above, undergo in that opinion a process of evolution. For later the Court says:[43]

> It [the tax] is laid upon every purchaser, within the state, of goods for consumption. . . .

Still further on:[44]

> Here the tax is conditioned upon a local activity, delivery of goods within the state upon their purchase for consumption.

And of both the *Felt & Tarrant* and the *Du Grenier* cases, it was judicially observed that[45]

> . . . the tax was imposed on all the sales of merchandise *for which orders were taken within the city* and possession of which was transferred to the purchaser there.

The results reached in the *Jagels* case appear at war with the statements quoted immediately above; that is apparent. In construing what the Court said, due regard must be given to what it actually did in this companion case decided at the same sitting, and to what has latterly transpired.

For in two cases decided on February 17, 1941, the Court upheld the Iowa use tax imposed by the state in which delivery was made, even though the purchases were pure mail-order transactions.[46] The cases were presented under the due process clause and there is language in the decisions which indicates that a different result might have been reached if the Sears, Roebuck and Montgomery Ward companies had not been admitted to do business in Iowa. From the standpoint of a consideration of commerce clause problems, however, these cases indicate that delivery, of itself, will be a sufficient basis for the imposition of a tax, because the economic thrust

[41] McGoldrick v. Berwind-White Coal Mining Co., *supra* note 1, at 43-44 (ital. added).

[42] *Id.* at 64, 68 (ital. added).

[43] *Id.* at 49.

[44] *Id.* at 58.

[45] *Id.* at 77 (ital. added).

[46] Nelson v. Sears, Roebuck & Co., 312 U. S. 359 (1941); Nelson v. Montgomery Ward & Co., 312 U. S. 373 (1941).

cannot be duplicated elsewhere, and hence an equality of competitive opportunities is maintained between local and interstate transactions.

INTERRELATIONSHIP OF COMMERCE AND DUE PROCESS CLAUSES

That there is a definite relationship between the due process clause of the Fourteenth Amendment and the commerce clause is apparent.[47] In many cases the identical result is reached whether one clause or the other is invoked.[48] The Fourteenth Amendment is a general limitation upon the powers of the respective states, the commerce clause a special limitation. During the era in which the states relied primarily upon a property tax system for their revenues the Court maintained that if the projected state action was beyond its jurisdiction as measured under the Fourteenth Amendment, it *a fortiori* constituted an invalid regulation of interstate commerce. Strictly, all cases involving property taxes should have been decided under the due process clause of the Fourteenth Amendment—this because the exaction's vice was that it reached property outside of the territorial jurisdiction of the taxing authority. Such a tax was void whether the owner of the property was engaged in interstate or in intrastate commerce. Later when the states taxed as property the intangible assets of one engaged in interstate business as a going concern, a new problem was presented as to whether the method used by the state had reached more than the taxing jurisdiction's fair share of the intangible assets. In the absence of an affirmative showing that the assessment had actually touched property outside of the state, such taxes were uniformly upheld.[49]

The next step was to permit the taxation of one engaged in interstate transportation by utilizing the gross receipts as a measure of the tax in so far as such taxes were in lieu of other taxes. But with the advance of taxes measured by gross receipts generally, it has become increasingly difficult to harmonize the results reached under these two clauses of the Federal Constitution. That the Court believes that the same results are to be achieved under certain circumstances is vividly illustrated by *Gwin, White & Prince, Inc. v. Henneford*.[50] There is also the suggestion in *J. D. Adams Manufacturing Co. v. Storen*,[51] that if the taxing statute contains a method of allocation such that only the fruits derived from the taxing state are included in the measure of the tax, taxes assessed thereunder will not be held to violate the commerce clause. This allocation suggestion the Supreme Court has repeated on several occasions.

[47] GAVIT, THE COMMERCE CLAUSE (1932) 47 *et seq.*

[48] *Cf.* Cleveland, C. C. & St. L. Ry. v. Backus, 154 U. S. 439 (1894), with Pittsburgh, C. C. & St. L. Ry. v. Backus, 154 U. S. 421 (1894). *See* also, St. Louis v. Ferry Co., 11 Wall. 423 (U. S. 1870); Delaware, L. & W. R. R. v. Pennsylvania, 198 U. S. 341 (1905); Louisville & N. R. R. v. Greene, 244 U. S. 522 (1917); Illinois Central R. R. v. Greene, 244 U. S. 555 (1917); Union Tank Line Co. v. Wright, 249 U. S. 275 (1919).

[49] Western Union Telegraph Co. v. Massachusetts, 125 U. S. 530 (1888); Cleveland, C. C. & St. L. Ry. v. Backus, *supra* note 48; Western Union Telegraph Co. v. Taggart, 163 U. S. 1 (1898); Adams Express Co. v. Ohio, 165 U. S. 194 (1897); Henderson Bridge Co. v. Kentucky, 166 U. S. 150 (1897); American Express Co. v. Indiana, 165 U. S. 255 (1897); Adams Express Co. v. Kentucky, 166 U. S. 171 (1897); Keokuk, *etc.*, Bridge Co. v. Illinois, 175 U. S. 626 (1900); St. Louis & East St. Louis Electric Ry. v. Missouri, 256 U. S. 314 (1921); Southern Ry. Co. v. Watts, 260 U. S. 519 (1923); Schwab v. Richardson, 263 U. S. 88 (1923).

[50] *Supra* note 26.

[51] *Ibid.*

However, it would seem that, from a practical standpoint, such allocation remedies are destined to be sterile, because the tax measured by a part of the gross receipts in the state of origin would, when the goods were shipped into a state of ultimate delivery, result in interstate commerce bearing an added fiscal burden *merely because interstate commerce was being done*. The concept that the state of origin will not be permitted to impose a tax measured by the gross receipts of a sale resulting in delivery into another state seems to be as inseparable as a pair of shears from the results reached in the *Graybar Electric Co.*,[52] the *Berwind-White*, and the *Sears Roebuck* cases. Such an apportionment statute would, moreover, bristle with perplexities from the standpoint of both draftsmanship and administration. For the present, therefore, it seems unlikely that any state will attempt to apportion gross receipts used as a measure of an excise other than to separate it into receipts derived from a source within the taxing state, and income from sources outside of that jurisdiction. The assumption which seems to be behind the result reached in the second *Dravo Contracting Co. v. James* case[53] would indicate that the state within which delivery was made (or the contract fulfilled) was entitled to use the entire receipts from such a source in measuring the taxes on activities within that state.

POSSIBLE DEVELOPMENTS

The probability most likely to be realized within the next few years is the adherence by the Court to the multiple tax doctrine as expounded in the *Western Live Stock* case and as developed in the New York City sales tax cases. There are, however, several other possible developments which should be mentioned.

(1) In the dissenting opinion in the *Adams Manufacturing* case, Mr. Justice Black indicated his willingness to repudiate the negative implication theory as it relates to problems arising under the commerce clause.[54] Many who have studied the past writings and records of Justices Frankfurter and Douglas believe that they may be expected to join Mr. Justice Black in insisting that whether state taxes are a prohibited burden or regulation of commerce is within the special domain of Congress. There appears to be some justification for this conjecture; however, in the Court as presently constituted it seems but a mere possibility. The consideration that in the practical results flowing from the multiple-tax doctrine Chief Justice Stone and Justice Reed can find themselves on common ground with Justices Black, Frankfurter, and Douglas, makes it unnecessary to repudiate the negative implication theory.

There can be no doubt that the most satisfactory approach to this problem would be to have Congress exercise its power to determine the permissive limits of state taxation touching interstate commerce by authorizing particular taxes and prohibiting those it finds discriminatory or destructive. The Congress can obtain factual data necessary for such a solution more easily than can the courts, and is, by its very nature, the agency in a position to piece together a comprehensive program. This cannot be accomplished within the confinements of the judicial process restricted to

[52] *Supra* note 21.

[53] 114 F. (2d) 242 (C. C. A. 4th, 1940).

[54] *Supra* note 26, at 331-333.

deciding single, isolated controversies wherein the facts are narrowed both by the rules of evidence and the limitations of the parties to the litigation. As the problem becomes more intense, this method of achieving a solution in an authoritative national manner will gain adherents.[55]

(2) Another possibility is that Congress may permit non-discriminatory sales taxation by the state of destination of solicitors and mail-order houses who ship goods into a state for ultimate use or consumption. Although Congress has not acted upon bills having this purpose, it is quite probable it will act favorably. But such action would yield to the states no power not already possessed by them under the new judicial dispensation.

(3) The state of Arkansas has evolved a technique[56] of a differential rate applicable to cities or incorporated towns which adjoin the state line. By the statute, where there are adjoining cities or incorporated towns which are separated by a state line, the taxes and licenses to be paid by dealers in and on sales and services in such cities or towns on the Arkansas side shall be at the rate provided by law in the adjoining state, if any, but in no instance to exceed the rate provided for by the Arkansas statute. This section has never been the subject matter of litigation. Many states are of the opinion that their state constitutions would prevent them from adopting a similar statute. Others believe that the provision is invalid under the Federal Constitution. All, including the taxing authorities of Arkansas itself, agree that the differential rate technique multiplies the administrative problems of the tax assessor, and while its use may be accepted for petroleum-product excises it is doubtful if it will be applied under the general sales taxes of the respective states.

(4) There is a definite possibility of ultimate adoption of the proposed Federal Manufacturers' Sales Tax with the allocation of collected revenues back to the respective states, as discussed in the 1935 progress report of the Interstate Commission on Conflicting Taxation.[57] There are strong factors which would indicate that it ultimately will be the technique relied upon to eliminate the litigation and administrative difficulties germinated by the commerce clause. This will not be accomplished without strong opposition from those who insist upon states' rights. This group feel that as the agency in collecting the funds and re-allocating them back to the states, the Federal Government will utilize the power inhering in such a situation to dictate state policies. They point to the record of the Federal Government under the grants-in-aid legislation and assert that state governments that have taken funds from the central government have always been required to surrender sovereignty over the subject matter upon which such funds were to be expended. The present defense endeavors and the foreign affairs crisis cannot fail to have a centralizing influence. This will condition the thinking of many persons in such a way that they will be willing to accept the proposed Federal Manufacturers' Sales Tax and allocation formula. Then, too, the drying up of state revenues, should a depression follow

[55] See Hellerstein and Hennefeld, *State Taxation in a National Economy* (1941) 54 HARV. L. REV. 949.
[56] ARK. DIG. STAT. (Pope, 1937) §14070(e).
[57] CONFLICTING TAXATION (Council of State Governments, 1935) 64-87.

upon the heels of the present defense boom, will undoubtedly influence the final result.[58]

The recent developments, beginning with *Gregg Dyeing Co. v. Query*,[59] and continuing through to this year's decision in *Nelson v. Sears, Roebuck & Co.*[60] represent progress toward the ideal of reaching realistic and practical results with reference to state taxation and the commerce clause. It is, therefore, to be hoped that the Court will some day recognize that sales and use excises should be allowed to disregard antecedent taxation in other states to the same extent and in the same manner that conventional property taxes now do so. In reality taxes, whether on property or on opportunities granted, are not an attempt at regulation.[61] When they are an attempt at regulation, the object is to prohibit or destroy the activity which is the subject matter of the legislation. This destruction of the source of the revenue, and therefore the revenue itself, is an indication that the matter under consideration is not a tax at all. The United States Supreme Court has had no difficulty in invalidating certain purported revenue measures because they were regulatory and therefore not in reality taxes. The historic statement of Mr. Justice Holmes, that "The power to tax is not the power to destroy, while this court sits"[62] will eventually be given its full application in the field of taxes measured by gross receipts as it has been in the property tax field. This eventuality, however, is for the far horizon.

[58] Similar conditions prompted the evolution of state collection of consumption taxes, with allocation back to the localities. See Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes*, *supra* this issue.

[59] *Supra* note 14.

[60] *Supra* note 46.

[61] Contrast the views of Hart, *Consumption Taxation as an Instrument of Economic Control*, *supra* this issue.

[62] Panhandle Oil Co. v. Mississippi, 277 U. S. 218, 223 (1928) (dissenting opinion).

THE FUTURE OF USE TAXES

Robert C. Brown*

The use tax has taken an important place in the revenue systems of the states. Sustained by the Federal Supreme Court as an excise rather than a property tax,[1] it has been adopted in a somewhat general scope by about twenty states.[2] As it is still a comparatively recent development, it gives every prospect of much wider adoption, unless developments to be discussed hereafter in this paper should cause it to be regarded as unnecessary or undesirable. Even the very few state courts which have expressed disagreement with the Federal Supreme Court as to the nature of the tax, and regard it as a property tax, have nevertheless sustained it as a necessary supplement to the state sales tax, and as a proper protection to local merchants.[3]

The Doctrine of the *Helson* Case

Apart from possible indirect effects of the use tax upon interstate commerce, which will be hereafter considered, the most serious judicial limitation of the use tax is embodied in the decision of the Federal Supreme Court in *Helson v. Kentucky*.[4] Here a Kentucky sales tax had been construed by the courts of that state as a use tax where the purchase was made outside the state. The *Helson* case held the tax unconstitutional as a direct burden on interstate commerce when applied to gasoline purchased in Illinois and used for the operation of an interstate ferry (from Illinois to Kentucky), though concededly 75 per cent of the gasoline was actually used in Kentucky.

This decision, twelve years old and consequently rather ancient as such matters go, is on principle perhaps justifiable on the ground of lack of proper apportionment,[5] though the opinion of the Court, written by Mr. Justice Sutherland, does not make any point of this. It was substantially a five to four decision, since Mr. Justice Stone (Justices Holmes and Brandeis concurring with him) agreed

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[1] Henneford v. Silas Mason Co., 300 U. S. 577 (1937).

[2] A number of other states impose taxes of the same nature as to gasoline, and a few as to other commodities such as oleomargarine and tobacco. While this paper is primarily concerned with the general use tax, it will consider these special taxes for purposes of analogy and contrast.

[3] See Nat. Linen Service Corp. v. State Tax Comm., 237 Ala. 360, 186 So. 478 (1939); Mann v. McCarroll, 198 Ark. 628, 130 S. W. (2d) 721 (1939).

[4] 279 U. S. 245 (1929).

[5] See McCarroll v. Dixie Greyhound Lines, 309 U. S. 176 (1940).

under protest, and only because of prior decisions of the Court. Curiously enough, the one complete dissenter was Mr. Justice McReynolds, who, however, wrote no opinion.

The *Helson* case, if still a binding authority, is a rather serious check upon use taxes with respect to actual facilities of interstate commerce. Its doctrine is still followed to the extent that a strict use tax with respect to gasoline or other commodity actually used as a facility of interstate commerce must be reasonably apportioned to the actual use in the state.[6] But otherwise the authority of the *Helson* case is today very doubtful. It is clear, for instance, that the doctrine of the case does not apply where the article taxed is used wholly within the state, even though imported from outside.[7] Neither does it apply where gasoline is purchased in the state even though it is used wholly in operating airplanes in interstate commerce,[8] and this despite the fact that here there is no use of the roads to justify the tax on that basis.

The loophole opened by the last-cited case was soon enlarged by two other decisions. In the first of these,[9] a Tennessee tax on the storage of gasoline within the state was upheld, even though the taxpayer was an interstate railroad and so would not use the roads on which this revenue was applied, and even though substantially all the gasoline would be used in interstate commerce. The Court distinguished the *Helson* case on its facts, but showed obvious disapproval of it. A similar doctrine was applied in the other case,[10] which involved air transportation, the state tax on the storage of gasoline being upheld even though the gasoline was bought outside the state. The *Helson* case was distinguished in that here the tax was on storage within the state and not on interstate flying. It seems that this distinction, while perhaps technically justifiable, is practicably unsubstantial.[11]

The Supreme Court itself has recognized that there is little left of the *Helson* case; that the distinctions which it has thus made are so narrow as to be almost nonexistent.[12] It thus seems that the opinion expressed by a number of commentators,[13] that the *Helson* case is substantially overruled, is correct. At least it is no longer a substantial restriction upon the taxing power of the states. Furthermore, the old doctrine, or whatever is left of it, has no effect whatsoever upon the much more important application of the use tax to goods within the state for other purposes than as a facility of commerce. Obviously such use has no direct effect upon interstate commerce, though, as will presently appear, there may be indirect effects which have to be considered. The point is that the *Helson* doctrine is substantially out, and needs no further consideration.

[6] Bingaman v. Golden Eagle Western Lines, 297 U. S. 626 (1936); McCarroll v. Dixie Greyhound Lines, *supra* note 5. Both of these cases involved the use of roads in the taxing state.

[7] Monamotor Oil Co. v. Johnson, 292 U. S. 86 (1934).

[8] Eastern Air Transport v. South Carolina Tax Comm., 285 U. S. 147 (1932).

[9] Nashville, C. & St. L. Ry. v. Wallace, 288 U. S. 249 (1933).

[10] Edelman v. Boeing Air Transport, 289 U. S. 249 (1933).

[11] See the comment on this case in the lower court in (1931) 45 HARV. L. REV. 385.

[12] See Coverdale v. Arkansas-Louisiana Co., 303 U. S. 604 (1938).

[13] See, *e.g.*, Lockhart, *The Sales Tax in Interstate Commerce* (1939) 52 HARV. L. REV. 553.

COLLECTION BY OUT-OF-STATE SELLERS

Because the use tax does not ordinarily involve commerce at all, it can properly be imposed on use within the state irrespective of how the goods can be or have been procured. It is clear that the tax can be collected from a distributor within the state, even though he has brought the goods from outside the state;[14] though in these circumstances a sales tax would seem to be just as effective.

A more serious problem arises when the purchase is made in interstate commerce. Here there is no possible objection to the imposition of a use tax upon the purchaser, but obviously the collection of the tax from these numerous people would impose an impossible burden of investigation and litigation. Much more practical, if otherwise possible, is it to collect the tax from the out-of-state seller.

The Federal Supreme Court has sustained such collection from a seller who had an office in the state, and this notwithstanding the fact that the sale was wholly in interstate commerce.[15] The actual burden thus imposed upon the seller was held to be within the power of the state even though the seller was not doing business within the state except in connection with interstate commerce. The same rule would seem to apply even more clearly if the seller is doing business in the state. The Iowa supreme court thought otherwise in the case of a mail-order house which had retail stores in the state.[16] That court held that such intrastate business did not authorize the state to compel the seller to collect the use tax on interstate sales, on the ground that this would be an improper burden on interstate commerce. The Federal Supreme Court refused, however, to follow the distinction and reversed the Iowa court, holding that the state may properly compel the seller to collect the tax.[17]

All this helps the states; but their troubles in collecting use taxes are not over. In the first place there is the problem of the interstate sale where the seller does no business in the state at all.[18] It seems clear that under such conditions the state is helpless so far as the seller is concerned.[19] One state (California) has partially solved the difficulty by threatening to ruin the local business of mail-order houses in this category through prosecution of a few of their customers for nonpayment of the use tax. Under this extra-legal pressure, mail-order houses have to a considerable extent been persuaded to pay the California use tax; and this expedient is no doubt open to other states.[20] However, it is imperfect, and is hardly applicable

[14] Monamotor Oil Co. v. Johnson, *supra* note 7.

[15] Felt & Tarrant Mfg. Co. v. Gallagher, 306 U. S. 62 (1939).

[16] Sears, Roebuck & Co. v. Roddewig, 292 N. W. 130 (Iowa 1940); Montgomery Ward & Co. v. Roddewig, 292 N. W. 142 (Iowa 1940).

[17] Nelson v. Sears, Roebuck & Co., 312 U. S. 359 (1941); Nelson v. Montgomery Ward & Co., 312 U. S. 373 (1941). The majority opinion was written by Mr. Justice Douglas. Mr. Chief Justice Hughes and Mr. Justice Roberts dissented.

[18] See Lowndes, *State Taxation of Interstate Sales* (1935) 7 MISS. L. J. 223.

[19] The supreme court of Iowa pointed this out in Sears, Roebuck & Co. v. Roddewig, *supra* note 16. The Federal Supreme Court, in reversing this decision, did not dispute the point, but did say that possible difficulties of the state in collecting the tax do not affect its jurisdiction to impose the tax.

[20] Another rather effective expedient for discouraging mail-order purchases is sometimes used, especially by New York City. Auditors are sent by the city to Chicago, or wherever the mail-order

except to a concern which has a sufficient number of such transactions to have built up valuable goodwill within the state. Otherwise the state is remitted to the unsatisfactory expedient of proceeding against the individual buyers.

Still more serious is the situation where the buyer goes outside the state and there purchases the goods. There being here no problem of interstate commerce at all, no possible objection could be urged to the imposition of the use tax. But it is obviously impossible to collect it from the seller, even though the seller does business in the state imposing the tax, since the seller cannot know where the buyer lives, and therefore to what use tax he may be about to subject himself.[21] Here, too, there is no expedient except to proceed against the buyer. It has been suggested that the growing tendency of the courts to enforce tax claims of other states might be helpful in this connection. While the Federal Supreme Court has abandoned the old and absurd doctrine that taxes are wholly unenforceable in other states, placing judgments for taxes within the protection of the full faith and credit clause,[22] it is by no means certain that this doctrine is applicable when no judgment has been obtained.[23] The states are generally disinclined to permit suits by other states for taxes, at least in the absence of reciprocity statutes, which are not common. It is therefore not clear how much help this doctrine would be for collecting use taxes.

Furthermore, such a suit would usually be unnecessary in the case of a claim against the purchaser-user of goods, since he is presumably a resident of the state imposing the tax. It might be useful where it is possible to hold the seller for the collection of the tax, but for most such cases there are more effective sanctions. The result seems to be that there are sufficiently broad powers of collection of the use tax from out-of-state sellers to assist greatly in its effective administration, but by no means to solve the practical problem of a reasonably complete enforcement of the tax.

NECESSITY OF THE COMPENSATORY FEATURE IN USE TAXES

Since, as will hereafter appear, the use tax was first devised as a supplement to the sales tax, it is ordinarily provided that the payment of the sales tax exempts the goods from the local use tax. But a multiple burden still exists, if a use tax must be paid over and above a sales or similar tax imposed by another state. To avoid this, a number of states employing use taxation have provided for a credit on the use tax of the amount of any sales or other similar taxes paid to other states. Such a provision is in the true sense compensating. But more than half of the use tax

house has its principal office, to audit the books as respects New York purchasers; and the unfortunate mail-order houses are compelled to pay the very liberal expenses of such auditors. Such burdens upon sellers have prompted the observation that even compensatory use taxes may in fact constitute substantial trade barriers. See Note (1940) 16 IND. L. J. 260. But see, in Gaubard, *Special Problems in the Levy of Municipal Excise Taxes, infra* this issue, a denial that such tactics are employed by New York City.

[21] This, too, is clearly pointed out by the Iowa court in Sears Roebuck & Co. v. Roddewig, *supra* note 16.

[22] Milwaukee County v. M. E. White Co., 296 U. S. 268 (1935).

[23] See Moore v. Mitchell, 281 U. S. 18 (1930).

states do not have any such compensating feature, and in at least one state the courts have explicitly declined to read such a provision into the law even where, as the court admitted, the burden thus imposed seemed rather unfair.[24]

Where a purchase is made outside the state, and is not in interstate commerce, there seems to be no federal question.[25] Indeed, a possible multiple burden in this case is at least arguably desirable as a protection to local merchants by discouraging purchases outside the state. In any event, the use tax is likely to be generally evaded, for reasons already pointed out.

When interstate commerce is involved, the collection of sales and use taxes by two states may possibly result in a substantial discrimination against such commerce. It is still the opinion of the Supreme Court that a flat discrimination against interstate commerce through the operation of state tax or other laws is unconstitutional,[26] though it must be admitted that some discrimination in fact is actually permitted.[27] The question is whether a use tax without compensatory features will result in such an unconstitutional discrimination against interstate transactions. While it remained the law, as was generally held until very recently, that no state sales taxes could be imposed on interstate transactions, this question was of hardly more than academic interest; but the Supreme Court decision in *McGoldrick v. Berwind-White Coal Mining Co.*[28] has changed the supposed rule to allow a sales tax in this situation.

The *Berwind-White* case permitted the sales tax to be imposed by the state of the buyer. The Court naturally did not pass upon the problem whether the state of the seller could likewise impose such a tax, though there is some authority which would tend to show that this tax would not be permitted.[29] If sales taxes in interstate commerce are restricted to the buyer's state, there appears to be no improper burden on interstate commerce, since the buyer will pay but one tax, either use or sales.[30]

But in this connection the New York case of *O'Kane v. State*[31] must be considered. Here the New York stock transfer tax, in effect a sales tax on stock, was sustained as respects a transaction where the seller was in New York but the buyer outside the state. This decision came after the *Berwind-White* case, and in fact definitely relied upon it. To the argument that the state of the buyer might impose a similar tax, thus doubly burdening the transaction, the court answered that

[24] State v. Fields, 27 Ohio L. Abs. 662 (1938). See also State v. Honaker, 25 Ohio L. Abs. 634 (1938).

[25] But *cf.* Note (1940) 16 IND. L. J. 260.

[26] Best & Co. v. Maxwell, 311 U. S. 454 (1940), a unanimous decision.

[27] See Federal Trade Comm. v. Bunte Bros., 312 U. S. 349 (1941).

[28] 309 U. S. 33 (1940). See also the companion case, McGoldrick v. Felt & Tarrant Mfg. Co., 309 U. S. 70 (1940).

[29] Robbins v. Shelby County, 120 U. S. 489 (1887); Gwin, White & Prince, Inc. v. Henneford, 305 U. S. 434 (1939). For discussion of this and other present constitutional problems in state taxation of sales, see McNamara, *Jurisdictional and Interstate Commerce Problems in Imposition of Excises on Sales, supra* this issue.

[30] See Lockhart, *supra* note 13.

[31] 283 N. Y. 439, 28 N. E. (2d) 905 (1940).

there was no multiple burden, since the two taxes would be upon different events. But this is merely a verbal distinction. The fact remains that there is a single transaction in interstate commerce subject (at least potentially) to two taxes, whereas an intrastate transaction is subject to only one. It would appear that if the *O'Kane* case is followed, and the state of the seller may thus impose a sales tax in an interstate transaction, there is an unconstitutional burden upon interstate commerce,[32] at least if the state of the buyer actually imposes a sales tax, as it clearly has power to do.[33]

With the use tax the situation may be somewhat different. Clearly there is no substantial burden upon interstate commerce if the use tax law includes a compensating feature, for in that case the transaction will bear a burden (however divided) only equal to the amount of the state use tax, to which intrastate transactions are likewise subject.[34] Furthermore, while a state use tax applicable only to interstate transactions would clearly be unconstitutional, it is not necessarily so if balanced by other taxes, whatever their names, imposing a like burden with respect to intrastate transactions.[35] Nor are taxes on transportation objectionable even when applied to interstate commerce since here "it is length of line, not interstate commerce, which makes another tax possible."[36] This is undoubtedly the justification for the clear rule that use taxes with respect to gasoline need not have any compensatory feature, since the tax must be proportioned to the actual use for transportation in the state.[37]

But when it comes to general use taxes, the problem is not so simple. The Supreme Court has invalidated state excise taxes of this general nature when applied to interstate transactions, on the ground that the other states might impose similar taxes with a consequent "multiple burden" upon interstate commerce.[38] It is not always easy to determine when the Court will find such a multiple burden,[39] and often the point is wholly ignored, especially in connection with use taxes.[40] Furthermore, the Court will sometimes sustain a state tax which in fact permits multiple economic burdens so long as the particular activity cannot be

[32] This point is well brought out in the elaborate discussion of the *Berwind-White* case in (1941) 6 Mo. L. REV. 57. See also discussions of the *O'Kane* case in (1940) 25 MINN. L. REV. 107; (1941) 39 MICH. L. REV. 490.

[33] See (1940) 26 CORN. L. Q. 158.

[34] But *cf.* Note (1940) 16 IND. L. J. 260.

[35] Hinson v. Lott, 8 Wall. 148 (U. S. 1869); Interstate Busses Corp. v. Blodgett, 276 U. S. 245 (1928); Gregg Dying Co. v. Query, 286 U. S. 472 (1932).

[36] Coverdale v. Arkansas-Louisiana Co., 303 U. S. 604, 613 (1938). But *cf.* Ozark Pipe Line Co. v. Monier, 266 U. S. 555 (1924).

[37] See Brown, *The Legal Aspects of Trade Barriers* (1940) 25 BULL. NAT. TAX ASS'N 98, 102.

[38] J. D. Adams Mfg. Co. v. Storen, 304 U. S. 307 (1938); Gwin, White & Prince, Inc. v. Henneford, *supra* note 29.

[39] See Cooney v. Mountain States Tel. & Tel. Co., 294 U. S. 384 (1935).

[40] J. Bacon & Sons v. Martin, 305 U. S. 380 (1939); Pacific Telephone Co. v. Gallagher, 306 U. S. 182 (1939).

taxed in any other state.[41] Thus a manufacturers' tax, though measured by selling price and with most of the goods sold in interstate commerce, has been approved.[42]

All this suggests that the Court is giving considerable weight to the nomenclature of taxes rather than to their actual burden. Certainly some state courts have indicated their opinion that this is a correct interpretation of the position taken by the Federal Court.[43] It may well be, however, that this position cannot validly be taken; it is quite as likely that the Court is reaching (though not always with entire success) for a test which will as nearly as possible equalize the burden between interstate and intrastate commerce, and is only using the technicalities of tax nomenclature as a means of justifying, or appearing to justify, the otherwise apparently irrational distinctions which it draws.

However this may be, we are concerned primarily with what the Court has said as to the use tax. In the leading case sustaining state use taxes,[44] the opinion by Mr. Justice Cardozo discusses the compensatory feature of the Washington law there at issue and correctly points out that this avoids any possibility of multiple taxation. This would have been clear enough had he not added:[45]

> Yet a word of caution should be added here to avoid the chance of misconception. We have not meant to imply by anything said in this opinion that allowance of a credit for other taxes paid to Washington made it mandatory that there should be a like allowance for taxes paid to other states. *A state for many purposes, is to be reckoned as a self-contained unit,* which may frame its own system of burdens and exemptions without heeding systems elsewhere. If there are limits to that power, there is no need to mark them now. It will be time enough to mark them when a taxpayer paying in the state of origin is compelled to pay again in the state of destination.

This *caveat* is made more emphatic by the later decision in *Southern Pacific Co. v. Gallagher,*[46] upholding the California use tax which has no compensatory feature.[47] Mr. Justice Reed, who wrote the majority opinion, attempted to justify a disregard of the effect of the commerce clause, on the ground that use within the state is not interestate commerce. This is obviously true, but it does not prevent the possible discriminatory burden upon interstate commerce if the use tax is put on top of a sales or similar tax imposed by another state. The Justice was finally compelled to recognize this proposition, but held that the tax would not be invalidated on account of a merely potential multiple burden; the multiple burden

[41] See Western Live Stock v. Bureau of Revenue, 303 U. S. 250 (1938). This follows the reasoning of the *O'Kane* case, *supra* note 31.

[42] American Mfg. Co. v. St. Louis, 250 U. S. 459 (1919). This doctrine has been followed even in such extreme circumstances as those present in Utah Light & Power Co. v. Pfost, 286 U. S. 165 (1932).

[43] State v. Fields, *supra* note 24; O'Kane v. State, *supra* note 31.

[44] Henneford v. Silas Mason Co., 300 U. S. 577 (1937).

[45] *Id.* at 587 (ital. supplied). Apparently encouraged by this language, the Washington legislature amended the statute in 1937 so as to eliminate the credit for out-of-state taxes. The statute still purports to provide for a "compensatory" tax, because giving a credit for Washington sales taxes. See Spokane v. State, 198 Wash. 682, 89 P. (2d) 826 (1939). [46] 306 U. S. 167 (1939).

[47] See Douglas Aircraft Co. v. Johnson, 13 Cal. (2d) 545, 90 P. (2d) 572 (1939).

must actually be shown.[48] He indicated that perhaps it would make no difference anyway, but explicitly declined to pass on this question.

The result would seem to be that the Court will not invalidate a state use tax merely because it has no compensatory provisions. Actual rather than merely potential multiple burden must be shown, and it is not even certain that the latter will be enough. All that one can say with any confidence is that the point is not yet settled.

With this uncertainty of the authorities, it is perhaps worth while to consider the problem on principle. The question is whether a general use tax which makes no allowance for sales, use or similar taxes imposed by other jurisdictions with respect to the same property, constitutes a substantial burden upon interstate commerce, and so may be regarded as a trade barrier.

The Corporation Counsel of New York City has recently urged that its use tax is not such a burden, in spite of its lack of any compensatory feature, and the consequent possibility of multiple taxation, on the ground that the municipality's use tax is substantially equivalent to a property tax.[49] There is undoubtedly something in this, since no personal property taxes are imposed by the city or state of New York. But this very fact shows that the argument has no general application.

Of more general scope is the argument of Professor T. R. Powell against the necessity of the compensatory feature.[50] He suggests that since the use tax applies to property acquired within the jurisdiction in an intrastate transaction as well as to property purchased in interstate transactions, there is no discrimination against interstate commerce. However, it seems to be invariably provided that a use tax will be credited with the amount of sales tax paid with respect to the property to the same jurisdiction; and if a sales tax or the like paid to another jurisdiction is not similarly credited, there is at least a potential discrimination against interstate commerce.

A still more fundamental argument has been advanced against the necessity of any compensatory feature for use taxes. This is that sales taxes are not necessarily, or even generally, shifted to the consumers.[51] In fact it is said that "courts are unbelievably naive" in their assertion that sales taxes are so shifted, and that the weight of economic opinion is to the contrary.[52] If sales taxes are not shifted to the consumer, the imposition of an additional use tax upon him is of course no substantial burden upon interstate commerce, since he is not thereby discouraged from purchasing in interstate transactions.

[48] *Cf.* (1940) 26 CORN. L. Q. 158.

[49] See Chanler, *The Interstate Commerce Clause and Local Municipal Taxes* (1941) 6 LEGAL NOTES ON LOCAL GOV. 81.

[50] See Powell, *New Light on Gross Receipts Taxes* (1940) 53 HARV. L. REV. 909.

[51] See Warren and Schlesinger, *Sales and Use Taxes: Interstate Commerce Pays Its Way* (1938) 38 COL. L. REV. 49.

[52] See *id.* at 71-72. For recent economic analyses, see Carlson, *Interstate Barrier Effects of the Use Tax* (1941) 8 LAW & CONTEMP. PROB. 223; Martin, *Distribution of the Consumption Tax Load, supra* this issue.

The writer, being a lawyer and not an economist, confesses his inability properly to appraise this argument. It must be realized that the problems of the actual burdens of taxation are quite as much economic as legal, and indeed probably more so. This is at least one of the reasons for Mr. Justice McReynold's remark that "Logic and taxation are not always the best of friends."[53] The present writer is inclined to feel that there is some naivete on the other side in the assertion that sales taxes are not largely shifted to the consumer; but the substantial economic opinion behind this assertion cannot lightly be disregarded. The result would seem to be that there is at least some danger (though no absolute certainty) of substantial trade barriers from use taxes, unless sales taxes are either abolished or else rigidly restricted to the state of the buyer. On the other hand, the arguments against this conclusion are sufficient to give some justification to the result which will probably be reached by the courts, that no such compensatory feature is constitutionally required. Here, as in several other instances, the courts will probably feel themselves unable alone to prevent what may result in a substantial trade barrier.

THE PROBLEM OF MOTIVE

Whether logically or not, the courts, in passing upon trade barrier problems, particularly with respect to taxation, have given considerable weight to the apparent motive in imposing the tax or other alleged burden. A tax which is considered to have been imposed primarily for the purpose of protecting local merchants, and thus imposing in effect an internal protective tariff, is much more severely scrutinized and much more readily invalidated by the courts than a tax which is thought to have been imposed for legitimate reasons of revenue, even though it has conceivably some adverse effect upon interstate commerce.[54]

With respect to this aspect of the matter, the use tax has an unusually clean bill of health. Until the *Berwind-White* decision,[55] it was universally considered that no sales tax could be imposed by the states upon sales in interstate commerce.[56] This was a definite discrimination, but in favor of rather than against interstate commerce; and the use tax was intended merely to equalize the burden. This equalizing feature of the use tax was recognized and relied upon even by the few courts which treated the use tax as a tax on property rather than an excise.[57] While even under these circumstances the compensatory feature is necessary in order to avoid a potential double burden where the purchase occurs outside the state,[58] as already pointed out this probably involves no federal question.

From this standpoint there is good reason for expecting judicial liberalism in

[53] Sonneborn Bros. v. Keeling, 262 U. S. 506, 522 (1923).

[54] Robbins v. Shelby County, *supra* note 29.

[55] McGoldrick v. Berwind-White Coal Mining Co., *supra* note 28.

[56] Typical state cases illustrating this proposition are Continental Supply Co. v. People, 54 Wyo. 185, 88 P. (2d) 488 (1939); Head v. Cigarette Sales Co., 188 Ga. 452, 4 S. E. (2d) 203 (1939); and Spokane v. State, 198 Wash. 682, 89 P. (2) 826 (1939). See also, Perkins, *The Sales Tax and Transactions in Interstate Commerce* (1934) 12 N. C. L. REV. 99.

[57] Note 3, *supra*.

[58] Note 24, *supra*.

upholding use taxes, even though the chief original reason for their introduction has been removed by the *Berwind-White* decision, and even though that decision and its possible extensions may result in a substantial burden upon interstate commerce. Certain it is that the Supreme Court has sustained state statutes which impose actual burdens upon interstate commerce, though rarely when such a burden was definitely intended.[59]

On the other hand, too much weight should not be given to this consideration. Legislative motives are difficult to ascertain, and indeed are traditionally rather improper subjects for judicial review. The motives for trade barrier legislation are mixed, and in any event the real test is, or should be, results and not motive.[60] It is true that motive is of some evidentiary value. But the courts should not permit a substantial trade barrier, through use taxes or otherwise, merely because the state or local legislative body did not apparently intend to bring about this result.

One other point should be mentioned in this connection. It is customary to provide in the use tax statutes that newcomers to the state need not pay a tax upon goods which they bought and used outside the state before they became residents of the taxing jurisdiction. In other words, the use tax is intended, at least in part, to protect local merchants, but not to the extent of penalizing persons for not buying there as non-residents, merely because they later become residents. This, too, shows a proper motive for imposing the use tax. The state may say that it does intend to protect local merchants, but only to the extent of equalizing the burden. Such a position seems entirely legitimate, though it is doubtful whether any federal question would arise in case the state did compel newcomers to pay a use tax upon household furniture and the like which they brought into the state, since this is not a direct burden on interstate commerce. Here again the use tax has the additional support of an unquestionably proper motive, but this should not save it if and when it becomes in fact a substantial trade barrier.

WILL EITHER THE SALES TAX OR THE USE TAX DISAPPEAR?

Inasmuch as the use tax was devised as a supplement to the sales tax, and particularly to remove the discrimination in favor of interstate commerce by reason of the doctrine that no sales tax could be imposed upon interstate transactions, the recent decision of the Federal Supreme Court repudiating this doctrine[61] has removed any further necessity for such taxes. For sales taxation, thus freed of the commerce restriction, has the important advantage that it is generally collectible directly from the seller so that the number of persons to deal with and the complications of collection procedure are much less than where collection must be made

[59] Sonneborn Bros. v. Keeling, *supra* note 53. A good illustration is the very recent decision of Fed. Trade Comm. v. Bunte Bros., *supra* note 27, though this is not a tax case. Here the Court sustained a state rule permitting a trade practice within the state which as respects interstate commerce had been forbidden as unfair by the Federal Trade Commission. The discrimination against interstate commerce thus permitted, is obvious and potentially ruinous, so far as that state is concerned.

[60] See Brown, *supra* note 37.

[61] McGoldrick v. Berwind-White Coal Mining Co., *supra* note 28.

from the buyers. It has therefore been argued that the use tax may now disappear, and the sales tax alone be used.

But the sales tax of one state cannot reach sales outside the state, though made to its residents. Whether such out-of-state sales are taxed where made or not, the state of residence of the purchasers, which is where the goods are used, loses if it depends solely upon a sales tax. Furthermore, it is not always practical to collect the sales tax upon interstate transactions. If the seller does no business in the state (other than interstate commerce) he may still be compelled to collect and pay the tax if he has a place of business in the state, but if the seller has no such place of business, the state is without remedy to collect the tax except by going against the buyers.

These objections to sole reliance upon a sales tax are at least largely obviated by the imposition of a use tax. Indeed, it has been suggested that the sales tax should be given up and the use tax taken as the sole method of collecting this class of revenue. From a legal standpoint, this suggestion seems better than the converse one of giving up the use tax and relying on the sales tax. Even the use tax may be collected from the seller provided the seller does business in the state or has an office there.[62] If not, the use tax cannot be collected from the seller; but, as already pointed out, neither can the sales tax. If then the choice is between these two taxes, it seems more desirable to retain the use tax and do away with the sales tax. Furthermore, if all the states did away with sales taxes, the use tax would cease to be a substantial trade barrier.

The choice which has been discussed seems, however, a quite unrealistic one. Why, as between a sales and a use tax, may not a state choose both? While a sales tax has perhaps no theoretical advantage over a use tax, yet experience makes it fairly clear that it is under some circumstances practically more desirable, at least from the standpoint of collection procedure. It is submitted, therefore, that the states should retain the use tax, and furthermore that there is no necessity of their giving up the sales tax, which may at times have important advantages. The two taxes should of course be largely integrated, both in substance and in collection procedure. Furthermore, in the writer's opinion, the use tax should be credited with sales or similar taxes imposed by other states. Such a provision is unnecessary if it is finally decided that only the state of the buyer can impose a sales tax; but otherwise there is apt to be a substantial trade barrier, though one which the courts seem likely to permit. Yet, at least with this limitation, there seems no reason why the states should not have, if they desire, the advantages of both of these forms of taxation. To give up either is not necessary or desirable.

[62] Nelson v. Sears, Roebuck & Co., *supra* note 17.

COLLECTION AND ENFORCEMENT OF STATE CONSUMPTION EXCISE TAXES

Joseph W. Huston* and John R. Berryman†

The problem of collecting and enforcing taxes arises from the fact that they are not self-enforcing; the mere existence of provisions in a statute book is only an authorization for a flow of money into the public treasury. Not until persons with legal authority to compel observance of the statute analyze its provisions, study its authorizations and limitations, and then enforce its terms does it become more than a list of words in a book.

The tax administrator is concerned only with the most effective employment of available means for achieving the end of adequate tax collections under the statute he administers. Of no moment to him are the social effects of his tax law. That is the legislator's concern, as it is the concern of the judiciary that both taxpayer and administrator observe the law.[1] The administrator's means for realizing the desired end are three. They are (1) the application of legal devices available for enforcing compliance, (2) the disposal of personnel and regard for "economic" factors affecting collections, and (3) the conduct of public and taxpayer relations. It is the purpose of this article to examine these means and to attempt an evaluation of them. Since nearly all tax administrators are faced with the problem of what "is" rather than what "should be," the distinction between theoretically perfect conditions and actual, less than perfect conditions is kept in mind throughout.

Application of Legal Devices

All tax laws contain legal devices designed to enforce compliance with their provisions. Any one of them is useful only in limited situations. The good tax law will therefore contain different "tools" for different situations, and the good tax administrator will use all the tools provided in the statutes to handle the various cranky col-

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† A.B., 1937, Amherst College. Assistant Supervisor, Division of Research and Statistics, Illinois Department of Finance. Co-author (with Joseph W. Huston), The A-B-C of Illinois State Finance (2d ed. 1940).

[1] Since it is only rarely that the judiciary has to deal with a case in which public revenues are endangered by an administrator's action, the real function of the courts is to act as an "umpire" in disputes arising between the administrator and taxpayers.

lection problems which inevitably arise. A brief review of the various tools made available by legislatures to tax administrators is thus in order.

Penalty provisions are the most common legal devices available for enforcement of consumers' excise taxes. They are of two types: civil penalties, usually in the form of a flat percentage addition to the tax upon failure to comply with the law, and criminal penalties, in the form of fine or imprisonment. Often, in addition to the civil penalty, provision is made for interest at the rate of one-half or one per cent per month for each month that the tax remains unpaid.

Penalty provisions are essentially devices to keep the rank and file of taxpayers "in line." The civil type constitute a mild form of economic coercion impelling the solvent and law-abiding taxpayer to eschew laxity in computing and paying his taxes. They may be looked upon as interest exacted by the state for failure to pay taxes by the date provided by law and as compensation for such trouble as the state may have to take to compel the payment of money rightfully owing to it. Viewed in this light, it would appear that civil penalties should advance in severity according to the length of time money is withheld, and according to the effort required to produce payment by the taxpayer.[2] On the other hand, penalties should not be so severe as needlessly to penalize taxpayers who make honest errors, nor so lenient that they represent merely a small rate of interest on unpaid tax so long as the taxpayer can succeed in withholding payment.

Criminal penalties are threats of more dire consequences than the mere payment of additional money, although they serve as a deterrent in the same manner that civil penalties do. In practice criminal penalties can be enforced only against the most flagrant violations. Even then, unless public opinion is thoroughly aroused, their attempted enforcement is an ineffective means of compelling compliance. Judges and juries are reluctant to see criminal tendencies in so popular a pastime as outwitting the tax collector, and the doctrine of "reasonable doubt" presents a welcome exit for their use.[3]

Penalties, civil or criminal, are of little avail against the determined evader. A taxpayer who will not pay his tax will likewise not pay an additional penalty without compulsion. And the inadequacies of the criminal law are glaring. While no respectable tax law should be without civil and criminal penalties, other more potent tools are also called for.

A common device for the enforcement of state motor fuel, liquor and cigarette

[2] The Illinois Retailers' Occupation Tax Act, for example, provides for a ten per cent penalty upon failure to make payments on time if payment is thereafter made prior to notice by the Department of Finance. If the Department is forced to determine the tax and make an assessment, the penalty is twenty-five per cent. Distinction is thus made between inadvertent non-compliance and willful failure to comply. Formerly, interest at the rate of one per cent per month was also charged, but the difficulty of computation led to repeal of this provision.

[3] The authors know of cases where taxpayers have openly refused to comply with the tax law by filing returns, have boasted publicly of their non-compliance, and have been acquitted by juries or assessed minimum fines by judges. In one instance a taxpayer operated for a period of years without payment of sales tax and after conviction by a jury was fined $100 by the judge. In another, the taxpayer was sentenced to jail but released after a few days by order of the court "pending appeal," although the same taxpayer had theretofore appealed to the state supreme court on the same grounds and had lost.

taxes is a requirement for a license, which may be revoked for non-payment of tax. Such a provision places in the administrator's hands a powerful weapon to enforce compliance if he uses reasonable diligence. While retail sales tax laws generally require licenses or certificates of registration,[4] express provision is not commonly made for revocation of licenses for violation of their provisions. This condition is paradoxical, since the need for such stringent requirements would seem even greater in the case of such taxes than in the case of motor fuel, liquor and tobacco taxes. Retailers, on the whole, have less capital and are more irresponsible than the wholesalers or "distributors" from whom these latter taxes are ordinarily collected. The barriers to use of the licensing device in state sales tax laws would seem to be economic and political rather than legal.[5] The typical retail merchant is the "little fellow" for whom legislatures have so much regard. To give tax administrators the power to put him out of business, even though adequate court review be assured, is repugnant; it is this which probably explains the lack in so many states of power to revoke licenses.[6]

A requirement that the taxpayer shall post a bond to guarantee payment of the proper tax is an effective protective device, in effect "insuring" the taxpayer's solvency. With reasonable diligence on the administrator's part, a bonding requirement solves the problem of uncollectible accounts, a problem which no other provision of law can effectively meet. Penalties, license revocations and other such devices are of no avail against insolvent taxpayers. Yet no retail sales tax law carries a mandatory provision for the posting of security; again economic and political barriers stand in the way. The premium on a tax bond is expensive[7] and in many cases taxpayers are not in a position to obtain a satisfactory bond without posting collateral, which they do not have.

Some state retail sales tax laws attempt to solve the problem by requiring the

[4] The following states require licenses or certificates of registration in connection with their retail sales taxes: Alabama, Arizona, California, Colorado, Delaware, Illinois, Iowa, Kansas, Michigan, Mississippi, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Utah, Washington and Wyoming. No license is required in Arkansas, Indiana and Missouri, and licenses are required only of importers by Louisiana.

[5] The sovereign, having the power to tax, has the power to enforce collection of the tax whether it is collected from retailers, wholesalers or manufacturers. In Dept. of Finance v. Gandolfi, 375 Ill. 237, 239, 30 N. E. (2d) 737, 738 (1940), commenting on the provision of the Retailers' Occupation Tax Act requiring a certificate of registration to be obtained by a retailer before engaging in business, the court said: "It is a well-recognized attribute of sovereign power to tax any occupation for the purpose of raising revenue, and to impose and collect the tax in the form of a license. (Price v. People, 193 Ill. 114; Banta v. City of Chicago, 172 *id.* 204). Defendants fail to recognize the distinction between enactments designed to supervise occupations under the police power, and administrative regulations intended to aid the enforcement of tax legislation. The power of the legislature to aid administration and collection of taxes by reasonable measures requiring license and imposing penalties is uniformly recognized. (People v. Werner, 364 Ill. 594; People v. Wilson Oil Co., *id.* 406; Citizens Water Works v. Hughes, 362 Ill. 136; People v. Chicago, Burlington and Quincy Railroad Co., 306 *id.* 62; Chicago, Rock Island and Pacific Railway Co. v. People, 217 *id.* 164.)"

[6] Little difficulty was encountered in adding a licensing provision, with power to revoke, to the Illinois Retailers' Occupation Tax Act. Ill. Laws 1935, p. 1201, now ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 120, §§441a, 441b. But the fear of political repercussions was so great that the administration then in power never exercised the right which the legislature gave to it.

[7] Tax bond premiums range from $12 to $18 annually per thousand.

posting of a bond only when the administrator has reason to believe that such action is necessary to avoid default.[8] Similar provisions are also found in some state tobacco tax laws, although here a few states require mandatory bonds.[9] Bonding requirements are much more common in the case of motor fuel and liquor taxes. The first type of tax is the oldest consumption excise, and experience in connection with it has demonstrated the wisdom of providing insurance that the state receive its revenues. The liquor business, only recently readmitted to legitimacy, is in no position to bring political pressure to bear. And both motor fuel and liquor taxes are typically collected from a few wholesalers or distributors, which makes it easier for legislatures to impose restrictions.[10]

States have sought to protect tax revenues by enacting statutory liens upon the property of taxpayers who may become delinquent. Where proper posting of security is required, liens are not necessary; but if this cannot be accomplished, a lien may be the "next best" device. Liens are especially useful in forcing payment by taxpayers who must maintain their credit with wholesale suppliers. Wholesalers will not sell merchandise to a retailer on open account if the property is subject to seizure by the state for unpaid tax liability. For this reason, a lien constitutes a powerful instrument to enforce payment in any case where the retailer is dependent upon wholesalers' credit to continue in business.[11]

Lien laws differ primarily in their provisions for the time at which the lien arises. The Michigan sales tax law, for example, states that the lien arises as soon as the tax is due, which is *when the sale is made*.[12] At the other extreme are a few states which declare that the lien does not attach until after notice to the taxpayer of final assessment, and after opportunity for judicial review. Most lien laws fall between these limits, the typical provision being that the lien attaches when the tax is due to be paid by the retailer and after notice of assessment.[13]

[8] Alabama, California, Kansas, Michigan, North Dakota, Utah and Wyoming provide for "discretionary" bonding in their retail sales tax laws. "Discretionary" bonds have the weakness that the administrator often will not be in a position to know of whom to require security until default is made, and thus have the shortcoming of "locking the door after the horse is stolen." There is also the legal question of the legislature's power to delegate this kind of authority to an administrative officer. In People v. Federal Surety Co., 336 Ill. 472, 475, 168 N. E. 401, 402 (1929), the Illinois supreme court invalidated a law permitting the Secretary of State to fix the penalty of a bond, saying: "The Legislature cannot delegate arbitrary power to any executive officer to say that under the same circumstances one rule of law shall apply to one or some individuals and another rule to others."

[9] New York and Iowa require bonds to be posted by all distributors under their cigarette tax laws. Ohio, Massachusetts, and some other states have discretionary bonding provisions. Even in tobacco tax laws, bonding requirements are not common.

[10] Tobacco taxes are also collected from "distributors," but, actually, a tobacco distributor may be a retailer who buys directly from the manufacturer outside the state. The result is that far more taxpayers are concerned directly with a tobacco tax than with a motor fuel or liquor tax.

[11] There is some question whether the interest of a purchaser under a conditional sales contract is subject to a tax lien. In General Motors Acceptance Corp. v. Whitefield, 62 S. D. 415, 420, 253 N. W. 450, 453 (1934), the court held that the interest of the conditional buyer in a chattel is not his personal property so as to permit seizure under distraint for taxes. The court said: ". . . such lien could not attach to property rights which had always belonged to the appellant [creditor], with which the appellant had never parted, and which Bessler [taxpayer] had never owned, although he might have a contract right to obtain them."

[12] Mich. Pub. Acts 1939, No. 313, now MICH. STAT. ANN. (Henderson, Supp. 1940) §7.534.

[13] Lien provisions are in all but three state sales tax laws, being omitted by Louisiana (which provides

While the purpose of a lien is to preserve for the state property of the taxpayer out of which payment can be secured, by preventing his disposition of such property prior to discharge of the tax liability, security for the state must be carefully balanced against the evil of undue interference with normal business relationships. The language of some state lien laws would seem to indicate that a lien could attach "on suspicion"; when the tax authority feels that the taxpayer's full liability has not been declared and paid, it apparently may impose a lien immediately, without hearing.[14] It is questionable whether sufficient care can be exercised by a tax administrator to prevent such a device from working hardship on innocent purchasers of a retailer's property, or from seriously interfering with the normal course of a taxpayer's business by tying up his assets while proceedings are under way to determine whether any liability actually exists. The dilemma between non-interference with normal business practices and protection to the state becomes clear. Yet, if the state is not in a position immediately to set up a lien on a taxpayer's property, and must wait until he is given a hearing by the administrative body and the courts, unscrupulous taxpayers are afforded an opportunity to dispose of their property and thus defeat the state's rights.[15]

Probably the best compromise in this dilemma is to permit the lien to attach only after a hearing in which the administrative body has established that an amount of tax liability is due. This permits the administrator, by expediting the proceedings, to shorten the time during which a dishonest taxpayer may dispose of his assets to defeat the lien, and yet affords the taxpayer a hearing before his assets are impounded. The taxpayer, of course, is not deprived of his right to a review by the courts after an adverse decision by the administrative body, but the fact that the lien exists pending such review constitutes an incentive for him to obtain a quick trial rather than to attempt to draw out the proceedings in the hope of delaying payment.[16]

In Illinois, an enforcement device lying outside of any taxing statute has been used to garner "uncollectible" accounts. Under the Illinois Corporation Act a corporation which violates "any State law" is subject to receivership upon application to a court by the Secretary of State on complaint of the injured party.[17] The Department of Finance has, upon occasion, petitioned for appointment of a receiver to take over the assets and business of delinquent corporations. This procedure was adopted

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for a lien only upon importers), Ohio and Oklahoma. The Arizona lien operates only against the purchaser of a business owing sales tax. ARIZ. CODE ANN. (1939) §73-1317.

[14] *E.g.*, CAL. GEN. LAWS (Deering, Supp. 1933) act 8493, §26.

[15] While, theoretically, property disposed of fraudulently to defeat a lien may be made subject thereto, actually it is next to impossible to prove fraud. Assets can be transferred to a new corporation or chattel mortgages executed in favor of interested third parties, leaving the state an empty shell with no real recourse.

[16] At the time the lien sections of the Illinois Retailers' Occupation Tax Act were added in 1937, an effort was made to obtain the kind of provision here recommended. Fear on the part of some legislators that retailers' property might be arbitrarily "tied up" caused its rejection, there being adopted in its place a provision allowing the lien to attach only after all court proceedings for review have terminated, or the opportunity therefor has expired. Ill. Laws, 1939, p. 880, now ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 120, §444a.

[17] ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 32, §157.82.

for use against corporations which saw fit to use "devices" to make their assets execution-proof, or against corporations whose assets were subject to prior liens, or which for any other reason could not be reached by ordinary procedures. Ordinarily, upon appointment of the receiver the corporation officials have hastily made arrangements to pay up back liability. In some instances, the Department's receiver has actually carried on the business for a period of time, applying all receipts and free assets toward payment of the tax delinquency.

Many states have enacted provisions limiting the period during which unassessed taxes are legally collectible. Statutes of limitations are not ordinarily considered as collection devices, but, paradoxically, such provisions may actually aid enforcement. In the absence of some limitation on the period for which the state can assess past liability, it is necessary, when audits of taxpayers are made, to check back to the effective date of the tax, if the taxpayer has been in business that long. Audits for so long a period are poor administrative devices. Taxpayer resistance in these instances is great, and courts are often reluctant to enforce collection of taxes that have lain dormant for long periods.

But this is only part of the problem raised by long periods of taxpayer liability. It is not necessary, and never has been, to enforce a tax against every taxpayer. To impel payment by a taxpayer, it is merely necessary that he be made to know that his delinquency will be quickly ascertained and that action will be taken against him. A statute of limitations, by limiting the period of business operations which must be audited, allows a given force of auditors to perform more individual audits each year. This means that a larger proportion of taxpayers can be audited every year, thus increasing the risk for any one taxpayer that his delinquencies will be detected. When taxpayers are aware of the risk of detection, they will be impelled to pay their just liability. The physical impossibility of auditing the greater number of retailers under a sales tax makes a statute of limitations much more important in this instance than in the case of motor fuel, liquor and cigarette taxes, where the number of taxpayers is typically smaller and financial responsibility greater.

In drafting a statute of limitations, the selection of the period after which unassessed taxes are not recoverable is the major problem. The period must strike an empirical balance between one sufficiently long to prevent important amounts of liability from going unpaid and one short enough to relieve auditing departments of the burden of checking back for many years.[18]

The device of the informational return is common in implementing enforcement of state consumption excise taxes. Informational returns may or may not be explicitly provided by law. Motor fuel, cigarette and liquor tax laws often provide that carriers transporting the taxed articles into the taxing state shall keep records of goods so transported and make them available to the taxing authority. Under such laws, also, it is often required that dealers receiving the taxed articles so keep their

[18] After study of its own situation, the Illinois State Department of Finance requested of the Illinois General Assembly a three-year limit, which became law in 1939. ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 120, §443.

books that the taxing authority can trace the taxed commodity back to the distributor who is liable for the tax. Even in the absence of specific provision in the law, however, tax administrators can use informational returns if the law gives the power to subpoena relevant papers and documents or other information. Thus, in enforcing sales taxes where retailers either have no books or there is some reason to question the veracity of a taxpayer's accounts, a check of the wholesalers from whom the retailer buys will often build up a case against the retailer. Indeed, this is sometimes the only way in which anything approaching the true liability of some retailers can be discovered.

It would undoubtedly be desirable, viewed strictly from the standpoint of tax enforcement, to require that every party to a taxable transaction make periodic reports of such transactions. In other words, if the tax is imposed upon a distributor, it would be helpful if not only he, but the retailers to whom he sells, reported monthly to the taxing authority all their transactions concerning the taxed commodity. For example, the distributor of cigarettes upon whom the tax is laid reports the sale of a certain number of cases of cigarettes to a retailer. The retailer in turn is required to report receipt of the cigarettes. A discrepancy in the reports immediately throws suspicion upon the distributor. Such a procedure is theoretically possible under any consumption excise tax law, including a retail sales tax, even though the liability here is upon the retailer rather than the wholesaler or manufacturer. Nevertheless, such a system imposes burdens upon so many persons other than those legally liable for the tax that it is found in few state tax laws.

An important method of aiding in enforcement of liquor taxes is represented by exchange between states of information concerning liquor shipments out of, and into them. Liquor shipped from one state to another is not taxable by the exporting state under the commerce clause.[19] In order to protect themselves against diversion of liquor reported to be shipped outside the state, most of the states imposing liquor taxes have arranged to notify the state into which liquor is reported shipped of such shipment, naming the amount and kind of liquor and the consignee. The state receiving the information then notifies the exporting state when the consignee reports receipt of the liquor. Such a system, of course, depends entirely on the degree of cooperation existing between the states. A state which does not participate, or cooperates only perfunctorily, endangers the revenues not only of exporting states, but its own as well.[20]

"ECONOMIC" FACTORS AFFECTING THE COLLECTION OF CONSUMER TAXES

Probably the most important single factor determining whether or not a tax will be completely collected is the adequacy and quality of the field staff available to

[19] *Cf.* Adams Mfg. Co. v. Storen, 304 U. S. 307 (1938); Crew Levick Co. v. Pennsylvania, 245 U. S. 292 (1917).

[20] The so-called "dry" states have been found to be the worst offenders. With no revenues at stake, these states have taken no action even when notified of shipments of liquor into their jurisdictions. As a result, distributors in exporting states can with impunity report sales to bootleggers in dry states, thus escaping the exporting state's tax. That state, in turn, has no proof that the liquor allegedly exported ever left its jurisdiction.

enforce it.[21] Legislators and courts may control legal tools available to the administrator, but personnel is directly responsible to him and he is responsible for the results obtained by his staff.

Mentioned above was the fact that a tax does not have to be enforced against every taxpayer. Much more important than the liability uncovered directly by auditors and investigators is the amount "scared in" by taxpayer knowledge that the law is being enforced. Statistically, these two sources of additional liability are difficult to distinguish, and it is unimportant that they cannot be. It is the amount of additional liability paid both as direct and indirect result of the employment of additional field workers that matters to the tax administrator.

Statistical study of sales tax collections by the various states shows a striking correlation between the number of retail stores per auditor and investigator and the proportion of sales tax not collected; the larger the number of stores per field worker, the larger the share of the tax unpaid. The following table compares the adequacy of collections with the relative enforcement staff in each of the five most populous states levying retail sales taxes.

TABLE I

ESTIMATED PERCENTAGE OF TAX LOST COMPARED WITH NUMBERS OF RETAIL STORES IN FIVE POPULOUS SALES TAX STATES[22]

State	Adjusted Taxable Sales 1940[a] (000)	Sales Tax Rate	Potential Yield of State Tax Rate times Adj. Retail Sales (000)	Actual Collections 1940 (000)	Tax Lost 1940 (000)	Per cent Lost	Retail Stores Per Field Worker
California	$3,444,033	3%	$103,320	$102,939	$ 381	0.4%	182.5
Illinois	3,508,000	3%	105,240	97,810	7,430	7.0%	259.2
Michigan	2,362,200	3%	70,866	66,784	4,082	5.8%	285.6
Missouri	1,398.931	2%	27,979	24,437	3,542	12.7%	483.6
Ohio	2,009,357	3%	60,281	52,975	7,306	12.1%	487.1

[a] Retail sales reported by the Census Bureau for each state were adjusted to obtain a figure representing taxable sales in each state.

[21] An adequate "field staff," which includes auditors, investigators, inspectors, *etc.*, is assumed to have the necessary supporting office personnel in the form of supervisors, clerks, hearing officers, and the like. But it is the field staff which is the "spearhead" of tax collection activity. Other employees, while necessary, contribute only indirectly to tax enforcement.

[22] The following calculation for Illinois indicates the manner in which the figures used in the table were computed:

ILLINOIS

Collections: 1940 Sales......................		$ 97,809,705
Deduct Tax Reflected in Retailers' Occupation Tax But Not in Census:		
Wholesalers and Jobbers..................	$5,553,795	
Manufacturers and Producers..............	6,548,861	
Garages and Repair Shops.................	1,734,910	
Hotels	2,000,000 (Est.)	
Barber and Beauty Shops..................	80,508	
Shoe and Harness Repair..................	69,179	
Photographers	50,968	

In these figures lies strong evidence of the necessity for adequate personnel. The addition of field employees sufficient to bring the other four states up to the scale employed by California, which enjoys practically complete collections, would obviously yield enormous dividends. In the case of Illinois it is estimated that expenditure of $554,000 a year to hire the 177 additional auditors, investigators and supporting office personnel necessary to equal the California level, would add approximately $7,000,000 a year to Illinois sales tax collections.

It goes without saying that mere number of personnel does not insure a successful tax department. The fact that complete retail sales and other consumption excise tax collections seem to go hand in hand with an adequate number of people engaged in tax enforcement is far from meaning that qualifications of employees are unimportant. The seemingly close connection between completeness of collections and the number of field employees (supported by proper office personnel) only indicates that in the states reviewed the *average* degree of efficiency per employee is at a high level, and about the same in each state.

Disposal of field staff in accordance with economic realities is certain to have a favorable effect on the collection of consumer excise taxes. By concentrating the efforts of auditors and investigators in certain areas, both economic and geographic, liability discovered and "scared in" by them can be substantially increased. An economic area may be a classification or sub-classification of business, such as automobile dealers or taverns under a retail sales tax, or may be all businesses of a certain size which are subject to a tax. Geographic areas, of course, may be all businesses in a county or city, or certain types of businesses therein.

Morticians and Funeral Directors	299,480	
Bowling and Billiards	134,827	
Total Deductions		$ 16,472,528
Net Tax Included in Census		$ 81,337,177
Add Estimated Tax Not Reflected in Retailers' Occupation Tax But Included in Census:		
Trade-ins	$1,105,000	
Illinois Motor Fuel Tax—(not part of sales tax base)	1,386,000	
Interstate Commerce	3,022,000	
Total Additions		$ 5,513,000
Net Comparable Tax		$ 86,850,000
Retail Sales—Ill. 1939 Census		$2,857,646,000
Retail Sales—Ill. 1940 (1939 = 100)		1.09
Estimated Retail Sales Reported by Census—1940		$3,114,834,000
Tax at 3%		93,445,000
Net Comparable Tax		86,850,000
Collection Ratio		92.94%
Total Possible Tax ($97,809,705 ÷ 92.94)		$ 105,240,000
Adjusted Taxable Retail Sales ($105,240,000 ÷ .03)		$3,508,000,000
3% Tax Should Yield		105,240,000
Actual Tax Collected		97,809,705
TAX LOST, 1940		$ 7,430,295

The tax administrator can discover a great deal about the most fruitful areas for audit and investigation from material readily available to him. Valuable information can be obtained from a study of the results of past audits and investigations. Other and more technical knowledge can be gotten from statistical analysis of taxpayers' returns over a period of years. And there is a good deal of information of the "horse sense" variety knocking around inside the heads of field workers which can profitably be assembled by the tax administrator.

One of the most immediate facts disclosed by a study of the results of audits and investigations of the objects of a retail sales tax will probably be that concentration on the larger taxpayers offers very lucrative returns, both in amounts directly uncovered by audit and the amounts "scared in" from other large taxpayers. A study of sales tax audits made by the Illinois Department of Finance disclosed that the liability discovered in auditing the smallest taxpayer (under $5.00 monthly) did not justify the cost of the audits, whereas the Department on the average assessed eleven and one-half times as much as the cost of the audits in the case of taxpayers with tax liability exceeding $1,000 per month, not to mention the additional amounts secured indirectly by knowledge that audits of large businesses were being made.

Statistical analysis of returns made in past years will produce a great variety of information which can best be used in connection with a study of the results of past audits. Occasionally such analysis suggests new fields for concentration. A study of Retailers' Occupation Tax returns in Illinois[23] disclosed very large variations in the proportion of total tax liability collected for various kinds of retailers, ranging from over 100 per cent[24] to as low as 65 per cent. The same study disclosed geographic variation in relative completeness of collections. This geographic variation was found largely traceable to differences in the economic development of the several areas of the state. Comparable collection ratios were discovered for areas homogeneous with reference to location, purchasing power and degree of urbanization. Analysis by size of monthly tax returns confirmed the study of audits and investigation results in that the largest total delinquencies discoverable, as opposed to proportion of delinquency discoverable, were concentrated in the large retail businesses.

Intelligent use of these various kinds of information will instruct the administrator in the proper disposal of his field staff. As was mentioned earlier, he should be guided by the largest dollar volume of liability which can be discovered and "scared in" by a given personnel. There are too many variables to be considered to permit of nice mathematical computation of the optimum disposal of field staff, but very intelligent approximation of the best alternative combination can be made with the information above outlined.

The amount and structure of exemptions from the tax base are important factors affecting collection and enforcement of consumer taxes. Economically, exemptions

[23] Ill. Dep't of Finance, *Completeness of Collections under the Retailers' Occupation Tax Act* (MS).

[24] In interpreting collection ratios, it should be kept in mind that such a ratio is a statistical concept which may sometimes exceed 100 per cent. A familiar example of such a concept is the percentage of steel mill capacity, which of late has generally exceeded 100 per cent.

include every tax-free event which is connected with taxable events. Whether implicit or explicit, they result, of course, in a direct loss of revenue. Administratively this is not a problem, however, for exemptions are a matter of law.[25] It is the indirect loss of revenue due to the existence of exemptions which concerns the administrator. Exemptions produce indirect losses of revenue because they offer taxpayers the opportunity to report their transactions as taking place in the tax-free area. Dishonest taxpayers have an incentive to report as tax-free, transactions which in fact are not. Honest taxpayers are inclined to give themselves the benefit of any doubt. The result to be expected is under-reporting of taxable transactions, especially in "mixed" businesses having both taxable and non-taxable sales.

It would likewise be expected that the absence of a tax on "wholesale sales" would lead to incomplete reporting. Where sales for resale are not taxable, retailers, in spite of contrary provisions in the laws, are in the habit of reporting only such of their sales as they deem taxable, rather than reporting all sales and claiming exemption for some of them. The implicit exemption of such sales thus has the economic effect of actual exemption. Taxation of sales for resale, even at a nominal rate, prevents the non-reporting of these events. Such reporting enables the tax authority to trace sales through the retail stage on the basis of wholesale tax data, and thus to detect evasions.

This reasoning seems to be borne out by available statistics. According to a study of the subject, those states with relatively broad sales tax bases show consistently better collection effectiveness than the narrow-tax-base states.[26] Noteworthy is the fact that taxation of sales for resale has a most pronounced effect on collection effectiveness.

Economically, high tax rates adversely affect collection effectiveness in two ways. One is, of course, an increase of taxpayer resistance as tax rates increase, making more administrative effort necessary for the collection of a given proportion of tax liability as the gains from successful evasion constitute greater incentives. The other is the flow of entrepreneurial effort away from enterprises subject to heavy tax rates as the tax raises the price of the taxed good and thus reduces demand for it. These two effects are statistically difficult to separate.

If it were possible to know what proportion of the observed drop in collection efficiency owing to higher tax rates can be ascribed to increased taxpayer resistance, estimates could be made of the increase in enforcement personnel and other steps economically best suited to counteract declining collection effectiveness as the tax rate rises. But until the effect of increased taxpayer resistance can be separated from that of decreased sales due to increased price, it does not appear safe to make recommen-

[25] Express and implied exemptions are treated by Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes;* Conlon, *Express or Implied Exclusions from Consumption Excises—Types of Consumers,* both *infra* this issue.

[26] Lack of space prevents adequate explanation here of this conclusion. Readers who are interested are referred to a forthcoming monograph, *Toward Effective Tax Collections,* by J. W. Huston and Thomas Lee Smith.

dations regarding steps to sustain the completeness of collections against the impact of rate increases.[27]

Tax stamps are commonly used in connection with taxes on liquor and tobacco. Those states taxing tobacco in any form have with one exception employed them.[28] Of the twenty-eight states which license and tax the sale of liquor, only four do not employ stamps as evidence of payment of tax.[29] Stamps are not suited to motor fuel taxes, and only one state, Ohio, uses them in connection with a retail sales tax law.[30] Tax stamps on liquor and tobacco are economic devices to the extent they advertise tax payment, their absence causing public notice of evasion. Requirement that tax-paid goods bear stamps as evidence of payment of tax is also a legal method to permit the seizure of contraband. The enforcement effect of stamp provisions lies in the power to confiscate unstamped goods, the seizure provision having the effect of a lien on the contraband.[31]

The fact that some states evidently do not consider the stamp method the only way to enforce excise taxes on liquor and tobacco makes the method open to some question. The tax stamp plan is relatively expensive; the stamps themselves are costly, often representing about as large a share of the cost of enforcement as all other items put together.[32] Discounts are very generally granted wholesalers for affixing the stamps, further reducing net revenue. The costs of examining the goods to detect contraband, of course, are a further element in the administrative expense of the stamp plan.

Statistically, the verdict on the necessity for stamps is mixed. Massachusetts seems

[27] Logically, it would be expected that increased taxpayer resistance would make each succeeding increment of liability more difficult to collect as the tax rate was increased. By that token, the collection of a given proportion of liability would be relatively increasingly expensive as the tax rate increased. To judge accurately the optimum addition to staff to counteract this effect, the administrator would have to be able to estimate the marginal liability uncovered (directly or "scared in") at each level of tax. Properly speaking, only a three-dimensional diagram could accurately represent the facts.

Martin, *Distribution of the Consumption Tax Load, supra* this issue, presents data on the effect of taxation on the demand for goods, especially those sold at a customary price.

[28] Massachusetts does not employ tax stamps, but uses a system of monthly reports such as is general under retail sales taxes.

[29] Connecticut, Massachusetts, New Jersey and New York.

[30] The Ohio stamp plan is not properly a legal device to aid enforcement. It is discussed *infra,* in connection with public and taxpayer relations as an aid in enforcement.

[31] In Ploch v. City of St. Louis, 345 Mo. 1069, 1079, 138 S. W. (2d) 1020, 1025 (1940), the court said, with reference to plaintiff's claim that the seizure provisions of the St. Louis cigarette tax violated the search and seizure clause of the state constitution: "It is clear that it was not intended to declare a forfeiture of title to unstamped cigarettes, for it is provided that the balance of the proceeds of the sale, after the payment of the tax, penalty and costs, must be paid to the merchant or person who was in possession of the unstamped cigarettes. In effect, under said section, the tax is a lien on the cigarettes which may be sold, as therein provided, to enforce payment of the tax. 'The mode of levying and collecting taxes is a matter confided to the legislative power, and such laws are "laws of the land."' [De-Orman v. Williams, 93 Mo. 158, 163, 5 S. W. 904, Sec. 9915, R. S. 1929.]" Even if no provision is made to pay any balance remaining after settling the state's claim, the same would still apply, for the penalty could be considered as consisting of the proceeds of the sale. It is clear, further, that seizure without a warrant is no violation of right. Any representative of the taxing authority who sees a violation take place may arrest the violator without warrant. However, he may not, without a warrant, search for contraband against the will of a suspected violator.

[32] In the fiscal year 1940, 46.2 per cent of the cost of administering the Illinois Liquor Tax was due to the purchase of tax stamps.

to be doing a good job of enforcement with its cigarette tax.[33] But none of the four states not employing stamps to enforce their liquor taxes ranked above the median in collection effectiveness as measured by a current study.[34] Until many other states attempt to enforce their cigarette and liquor taxes without stamps and the results can be adequately compared, it must be concluded that tax stamps are probably the most effective method of enforcing these taxes.

PUBLIC AND TAXPAYER RELATIONS AS A FACTOR IN EFFECTIVE TAX COLLECTIONS

Relations of the tax authority with the public and the objects of the tax can have considerable effect on the cost of collecting a given amount of liability. Public acquiescence in a tax, and unwillingnes to see it evaded, may favorably affect collections. Public knowledge of the need for a tax and of the use of its proceeds can create public sentiment in its favor. Similarly, taxpayer knowledge of enforcement methods and the regard in which taxpayers hold the administrative personnel may appreciably affect collection costs.

Public funds have been spent in some jurisdictions to gain public and taxpayer good will. The Illinois Division of Department Reports has been used to issue press releases regarding the operations of Illinois taxes, the disposition of their proceeds, and the need for the funds they bring to the state treasury. Research divisions of tax departments have sometimes issued pamphlets and other publications relating to the disposition of tax funds.[35] The taxpayer himself has been the direct object of some such material, frequently printed on the back of the forms provided for tax returns.[36]

Securing taxpayer cooperation has probably been considered more important than obtaining public acquiescence to a tax. One method of obtaining this cooperation has been the granting of discounts from tax liability, generally on the grounds that the taxpayer is put to some expense in collecting the tax. This practice is most common under tobacco tax laws, where discounts allowed for the cost of affixing stamps range as high as ten per cent in several states, although more usual ranges are between five and seven per cent. Discounts to distributors for collecting motor fuel taxes vary from zero in Florida, New Jersey, Rhode Island and Wyoming to four per cent in South Dakota, the more usual range being in the neighborhood of two per cent. A few states grant discounts in connection with their liquor and retail sales taxes.[37]

[33] By any of several measures of the Massachusetts share of the total number of cigarettes consumed in the United States, Massachusetts ranks high in collection effectiveness. The most reliable indices indicate that probably only one or two states do a better job.

[34] The reader is again referred to the forthcoming study cited *supra* note 26.

[35] *Cf.* HUSTON AND BERRYMAN, THE A-B-C OF ILLINOIS STATE FINANCE (2d ed. 1940); also Ill. Dep't of Finance, *Twenty-third Ann. Rep.* (1940).

[36] Compare the forms for Retailers' Occupation Tax returns in Illinois.

[37] Discounts for affixing liquor tax stamps are granted by Kentucky (3%) and Ohio (5%). Mississippi (dry) grants 5% on beer stamps. Sales tax discounts are: Alabama, 3%; Louisiana, 5%; Missouri, 3%; Ohio 3%; Oklahoma, 3%. Michigan exempts the first $50 of tax liability and Indiana exempts from taxation the first $3,000 of gross receipts. Compensation for retailers is indirectly provided in some states by statutory establishment of brackets for payment of tax. West Virginia, for instance, under its two per cent sales tax requires 1 cent to be collected on sales ranging from 6 cents to 50 cents and 2 cents on sales

There can be little doubt that affixing stamps to cigarettes or other tobacco products is a cause of added expense to tobacco distributors. There are probably some bookkeeping expenses connected with the payment of motor fuel taxes. At the same time, there does not seem to be any legal necessity for granting discounts.[38] The duty of affixing stamps or collecting the tax from consumers is imposed by law as much as is the taxpayer's duty of paying the tax. It is clear, then, that discounts have been used as a concession to distributors to obtain their cooperation.

Whether or not the ideal tax law should contain discount provisions is open to question. It has been contended that business practices in the wholesale cigarette business make it impossible to shift the cost of affixing stamps on to retailers.[39] The writers are not aware of any similar claim for discounts in the case of motor fuel and liquor taxes. Whether desirable or not, the rates of some of the discounts now in effect are clearly "out of line" with the added cost imposed. This fact can be established by reference to the provision in a good many states for different rates of discount according to the quantity of stamps purchased at one time. Georgia, for instance, grants a three per cent discount on cigarette tax stamp sales in blocks of $100 to $200, and a discount of ten per cent on sales of stamps in blocks of more than $200. The cost of affixing stamps would be expected, however, to fall as the number affixed rose, rather than to increase.[40]

An inexpensive way of creating, if not taxpayer good will, at least taxpayer acquiescence is the promulgation of reasonable and practical rules and interpretations of tax laws.[41] The taxpayer who believes that the rulings division is taking an intelligent and sympathetic interest in his problems may be mollified, even if it is held that his transactions are taxable. Willingness to make practical and workable compromises within the law can often prevent litigation and make available substantial amounts of liability which otherwise would be expensive or impossible to collect. An illustration of this can be found in the recent experience of the Illinois State Department of Finance. The Department was faced with the question of whether sales of

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of 51 cents to $1.00. This would clearly yield more than the two per cent of gross receipt the retailer must pay.

[38] *Cf.* Pierce Oil Corp. v. Hopkins, 264 U. S. 137 (1924); Texas Co. v. State, 31 Ariz. 485, 254 Pac. 1060 (1927); Standard Oil Co. v. Brodie, 153 Ark. 114, 239 S. W. 753 (1922).

[39] In a recent hearing before the Illinois Department of Finance regarding the granting of discounts in connection with a projected cigarette tax in Illinois, cigarette wholesalers were in complete agreement that the cost of affixing stamps (which they estimated at over 5% of the cost of the stamps) could not be shifted to retailers. Economists would argue, of course, that there is no reason why such costs cannot be shifted, at least to the extent of the lowest cost of affixing stamps enjoyed by any wholesaler. No valid argument was advanced why the "laws" of partial equilibrium theory should be suspended for cigarette jobbers.

[40] A similar view on rates of discount now allowed is expressed in Ratchford, *The Measure of Consumption Taxes, infra* this issue.

[41] Not all tax administrators are of this opinion. Henry F. Long, Commissioner of Corporations and Taxation of the State of Massachusetts, recently stated in regard to rules and regulations: ". . . I not only do not have any, but I do not believe in them as they have a habit of springing up and hitting you in the face when you least want them or expect them." Letter to Supervisor of Rules and Regulations, Illinois Retailers' Occupation Tax Division, April 28, 1941. This probably accurately reflects the attitude of most administrators, but inconvenience to the administrator must be weighed against the desire of the taxpayer to know where he stands.

baby chicks by commercial hatcheries were sales for resale or sales to consumers. Only the latter are deemed taxable under the Illinois Retailers' Occupation Tax Act. Hatcherymen protested bitterly against paying the tax, pointing out that many of their purchasers raised the chicks for resale as pullets.

In order to make a fair ruling, the Department distributed over a thousand questionnaires to farmers throughout the state; replies were received from approximately one-half of the recipients. From this sample it was estimated that about seventy-five per cent of baby chicks purchased by farmers are resold. A rule was therefore promulgated to the effect that "hatcherymen will be liable for tax based on 25 per cent of their receipts from sale of baby chicks in all cases where it is not shown that a different percentage is applicable. Such percentage shall be considered *prima facie* correct."[42] This ruling satisfied hatcherymen as to its fairness, and tax is now collectible from them without difficulty. Serious misunderstanding with this class of taxpayers might have made all tax for which they are liable slow and expensive to collect.

Of the states imposing retail sales taxes, nine employ tokens as an aid to collection of the tax. In effect, sales tax tokens are fractional coinage, used to supply a medium of exchange of less than one cent. Denominations of one, two and five mills have been issued by the different states, and a three and one-third mill token has been proposed in Washington for use with its newly-enacted three per cent tax. Agitation for the adoption of sales tax tokens has generally come from the merchants, especially from those whose business is in large share made up of small sales. Fractional coinage allows merchants to collect tax from consumers on sales which could not be reached under the "bracket" system.

The shortcomings of sales tax tokens are largely due to the uses to which they are put by consumers, who have either found them unhandy and tossed them into the streets, or who have found too great utility in them when employed for other purposes, such as poker chips, washers for roofing nails or in place of Chinese money to decorate portieres. Lately a tax administrator has come out strongly against them,[43] adding the excessive cost of the brass and aluminum from which they are usually made as an additional objection. This same statement points out, however, that there may be a place for them in states with low *per capita* wealth, where typical purchases are for small amounts, and collection of tax by the usual brackets difficult.

The Ohio sales tax law now incorporates a most interesting provision designed to secure public aid in enforcing the tax.[44] Whenever a taxable sale is made under that act the vendor is required to give the vendee a tax stamp in the proper denomination, which he has suitably mutilated so as to constitute cancellation. A 1939 amendment provides that the state will redeem cancelled tax stamps at three per cent of their face value and contribute the sum paid in redemption to any charity named by the

[42] Ill. Ret. Occ. Tax Reg. (1939) Rule No. 73.

[43] Dixwell L. Pierce, Secretary, State Board of Equalization, California, in a mimeographed release dated April 16, 1941, has argued against the adoption of tokens in California.

[44] Ohio Laws 1939, p. 40, now OHIO GEN. CODE (Throckmorton, 1940) §5546-26a.

purchaser submitting the cancelled stamps. Before installation of the incentive for retaining cancelled stamps, it is known that purchasers commonly discarded stamps on the premises of vendors, allowing their repeated use.

Sales tax tokens, and tax stamps such as those employed in Ohio, are both devices to secure public or taxpayer cooperation in collecting the tax. Tokens are a method of purchasing the good will of merchants so that they will be favorably disposed toward the tax and more willing to pay their just liability. The stamp-and-rebate scheme is likewise a method of purchasing cooperation, this time of the consumer. Neither tokens nor the Ohio stamps are, strictly speaking, legal devices for enforcing the tax. Liquor and cigarette tax stamps, of course, are legal enforcement devices, since the absence of tax stamps from liquor or cigarettes makes them liable for seizure.[45] This is possible only because there is a physical connection between the taxed article and the tax stamps; the stamps are affixed to the article itself. Under the Ohio tax stamp plan there is no such necessary connection; the tax stamp is not attached to the article as proof that it was sold tax-paid. The only sanction created by the Ohio plan is economic; if a merchant does not furnish stamps so that purchasers can contribute to their favorite charity, the merchant may lose business. He is in no danger of having his merchandise seized because of absence of stamps, and in no danger of prosecution for failure to purchase the proper amount of stamps so long as he makes some sales to persons who are more interested in the reduced price thus possible than in contributing to charity.[46]

The principal objection to the Ohio stamp-and-rebate plan is its cost. Net sales and use tax paid by consumers in Ohio in 1940 totalled $54,366,547. Administrative cost was $4,030,322 for the same period, of which $843,939 was for the redemption of stamps. Administration was thus seven and four-tenths per cent of net tax.[47] Collections, at the same time, appear to have been at no higher level than in some states which rely on returns and auditors alone.[48] Much more convincing evidence of the success of this plan is necessary before it can be recommended as a superior method of retail sales tax enforcement.

[45] See note 31, *supra*.

[46] A merchant who fails to pay the Ohio tax is, of course, liable to be prosecuted if his delinquency is discovered by audit. Audits, however, are a distinct enforcement device quite apart from the tax stamp system.

[47] Cost of administering the Illinois Retailers' Occupation Tax, during the same year, was approximately two per cent.

[48] See the table at p. 513, *supra*.

WHO ARE TAXABLE? — BASIC PROBLEMS IN DEFINITION UNDER THE ILLINOIS RETAILERS' OCCUPATION TAX ACT

Samuel Herman*

In the same sense, and perhaps to the degree, that all men are political animals, all men are consumers of the goods they produce. The tax directly premised upon the economic act of consumption of goods is, in the light of modern distribution of wealth, the tax most universally applicable and most burdensome. Although the consumers' tax is, in general, meant to apply to each individual as he engages in the act of consumption, administration of a consumers' tax is wholly unpalatable, and, hence, not feasible or practical when the tax gatherers are required to hold each consumer immediately responsible as the tax remitter. Minimum necessities of decent public administration in consumer taxation require that the number of all persons directly and immediately responsible to the tax agency be smaller than the number of all the consumers who actually pay the tax or directly bear its burden. To assure practical administration, the modern tax administrator must adjust tax gathering to modern distribution methods in consumers' goods.

So it is found that, wherever possible in the realm of consumers' taxation, "retailers" are made tax collectors on behalf of the tax agency. The retailer is a hybrid quasi-public official, bound under penalties of law to serve a public function in the collection of tax, simultaneously serving two masters, his government and his profit. A simple principle justifies this dual status to the tax administrator. In a typical state there is one retailer to every 50 to 100 consumers; it is, therefore, cheaper and easier to deal with the retailer. Even in such states as Illinois, where the consumers' tax is technically a "retailers' occupation tax," and the retailer is technically the "taxpayer," the retailer is actually a collector.[1] Whatever the legal theory, the retailer is, from

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[1] Ill. Ret. Occ. Tax Rules and Reg. (rev. Oct. 1, 1939), issued by the Department of Finance of the State of Illinois, distinguishes in Article 20 between the actual and the seeming as follows: (1) "The Retailers' Occupation Tax Act imposes upon retailers [that is, persons engaged in the business of selling tangible personal property to users or consumers] the duty of paying the State a tax at the rate of three per cent of the gross receipts from their business." (2) "[The Retailers' Occupation Tax Act] does not impose a tax upon the consumer." (3) ". . . but nothing contained in the [Retailers' Occupation Tax] Act prohibits a retailer, in fixing the price of his merchandise, from setting up as a separate item the amount of tax to be paid by him, provided that such separate item is identified as a part of the selling price." (4) "The retailer shall not, in any event represent to his customers that he is acting as an agent for the State in collecting a tax from them."

the point of view of the tax administrator, in essence a collector because he so considers himself.[2]

The anomalous quasi-public capacity of the retailer as either public or private tax collector stimulates conflicts between his public duties, enforced by statutory penalties, and his own self-interests as a competitor attempting to achieve competitive advantages over other retailers. Administrative definitions of what or who are taxable must consider at all times the role of the retailer in the tax-gathering process and, whatever the legal framework, specific definitions must be adjusted to the feasibility of actual collection by a retailer in specific circumstances. Statutory definitions of the "taxable transaction" or "taxable event" in consumers' taxes are characterized by limited enumeration and broad scope, affording to the tax administrator ample scope for interstitial policy-making. Administrative ruling attempting specific definition to achieve the Nirvana of tax administration—complete certainty and acceptance of tax liability by tax collectors and the taxpaying public—shifts, as a process, from legal semantics to economic policy-making. The technique of definition in these circumstances is neither wholly law nor entirely economics; it is a delicate and sometimes explosive mixture of both. These are the broadest of principles underlying the administrative process in consumers' tax definition.

In a tax as immediate and as pervasive as a general consumer's tax, definition of what is taxable must coincide, so far as rational, with the predisposition to functional classification prevalent among business men prior to enactment of the tax. Administrative definition cannot in too many instances risk running counter to industrial, retailing, or consuming views as to who is a consumer. Merely legalistic construction of statutory language without weighty regard to public functional experience or psychology adds cumulative irritant to the basic irritant of the consumers' tax itself and by a Gresham's law of litigation results in almost proportional resort to the courts by outraged taxpayers. The disposition of lower courts to invoke lay attitudes in deciding definitional issues in consumers' taxation is notorious and has plagued tax administrators everywhere.[3] In part this is due to a lack of judicial expertness in this field, in part to a judicial sensitivity to public attitudes toward administration of the unpopular and regressive general consumers' tax. It is axiomatic, therefore, that the excellent tax administrator will excel in the making of tax policy through definitions, laying stress on legalisms only as administrative strategy necessitates a practical prejudgment of what the courts in his state may be expected to do. His excellence, however, will not be tested by the astuteness of his legal formulation as much as by his ability to overcome, within the technical range of the statute, the stresses and strains in public psychology and confidence created by the general consumers' tax.

[2] Problems of state consumption tax collection and enforcement, including the basic matter here referred to, are canvassed in Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes, supra* this issue.

[3] A general analysis of judicial interpretation of the taxable transaction for consumption taxation is to be found in Cohen, *The Taxable Transaction in Consumers' Taxes, infra* this issue.

That there is a technical ambit within which specific definition must stay is, of course, elementary. Apart from the social implications of consumer taxation, and the sensitivity of the public to administrative extension or retrenchment by definition, it is a statute that must be construed. In Illinois, under the Retailers' Occupation Tax Act, the economic activities by which men live and accumulate wealth must be tested and taxed by the words: "Any transfer of the ownership of, or title to, tangible personal property to the purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration. . . ."[4] The tax (3%, 2% after June 30, 1941) is imposed on persons "engaged in the business of selling tangible personal property *at retail* . . ." measured by gross receipts from such sales.[5] ". . . for use or consumption and not for resale in any form as tangible personal property" are the basic words around which Illinois consumers' tax policy must be fashioned.

The quest for certainty is nowhere more exacting than where a taxpayer doubts that his own business activities come within the ambit of a sales, occupation, or other consumers' tax. Tax liability, in the context of retailing, has an important impact on normal competition. Most retailers suffer an occupational urgency to prevail upon the tax administrator that he treat all unusual facts as borderline, and, hence, doubtful, applying all doubts in favor of the retailer and his non-responsibility or non-liability. Characteristically, this urgency is implemented by another occupational urgency; no administrative tax definition is a sound definition which does not include or exclude within the range of tax liability the entire competitive context: that no competitive advantage be afforded, directly or indirectly, by administrative ruling. This concept of competitive advantage or disadvantage is not the same as, nor can it always be tested by, the ordinary legal principles guiding a determination of what constitutes "discrimination." The *motif* of individual or trade association argument when administrative tax definition is in course of formulation may be paraphrased as follows: "We deny that your classification is correct, but if you call a trade classification of retailers *'A,'* it is far worse that some members of *A* are ruled to incur tax liability and others not, than that all members of *A* are *improperly* ruled to incur tax liability." Given the practice by all members of *A* of tax shifting to their customers, the attack upon the tax administrator for improperly defining the whole category as taxable is of relatively minor consequence. In such circumstances the challenge of definition is legalistic, technical, carried on professionally, and often with due regard to whether tax monies are paid in escrow and whether successful litigation will result in the retention of such monies by the retailers themselves or in its return to those from whom the retailers have already collected a tax. But where definition purports to, but does not realistically define all members of *A* in terms of their mutual competitive interrelationship, tax admin-

[4] 24 ILL. STAT. ANN. (Jones, 1940) §119.450 (definition of "sale at retail").
[5] *Id.* §119.451.

istration commences to disintegrate in the face of a multiform attack which transcends the merely legal. The technique of administrative definition, to be successful, must be premised upon the most careful fact-finding as to the functional characteristics of those who exercise the taxable function or discharge the taxable event. It is basically a problem for those tax-policy-makers who can expertise in the peripheral aspects of the legal definition itself, in the economics of competition and consumption, in the permutations of public and group psychology generated by a regressive tax upon day-to-day living.

A basic problem in administrative tax definition happens to be the first problem in point of time. Should an agency administering a consumers' tax state, in detail and in advance, its views as to who are and who are not taxable, what is and what is not taxable? Or should the tax agency require the taxpayer to determine his own tax liability by consulting the statute and/or legal counsel, the agency reserving the right to agree or disagree with him after examining his tax return? To what extent and to what degree should the tax agency publicly define tax liability in advance of court adjudication? These questions necessitate some consideration of the rule-making function, normally given to the tax agency by the statute, which constitutes its legal justification to promulgate definitions.

Under the Illinois Retailers' Occupation Tax Act "the Department [of Finance] is authorized to make, promulgate, and enforce such reasonable rules and regulations relating to the administration and enforcement of the provisions of this Act as may be deemed expedient."[6] The Department of Finance deemed it expedient to promulgate nearly 100 "rules" relating to particular trades, professions, businesses and conditions affected by the act. Extensive circulation of these rules affords to Illinois taxpayers formal definitions as to specific tax liability. Selection of the subject to be specifically defined was, in general, determined by two distinct methods: (1) within a relatively short time after the enactment of the tax, those taxpayers who urgently pressed upon the tax administrators the contention that they were not subject to the tax obtained, owing to the sheer pressure of the economic burden exerted by customers who resisted the tax collection, a formal ruling containing a definition either including or excluding all similar retailers from the scope of the tax; (2) taxpayers who sought resort to the courts and obtained judicial rulings settling definitional issues in their favor, as opposed to the views of the tax administrator, obtained, as a matter of course, formal rulings promulgated by the tax administrator embodying the contrary position of the courts.

The impact of judicial action upon the administrative process of definition periodically results in revision of promulgated rulings to adjust other definitions to the rationale of the determinations reached in the courts. Hence in an examination of the publicly promulgated definitions of an agency administering a consumers' tax it surprises no sophisticated student of consumption taxation to note the prominence given to apparently trivial definitional formulations of tax liability, such as those

[6] *Id.* §119.464.

concerning picture framers,[7] monument vendors,[8] pest exterminators,[9] blacksmiths,[10] and the like. There is no necessary relationship between the amount of tax forthcoming from any taxpayer group and the need for publicly formulating a definition of liability. Where adequately conceived and formulated, such single definitions serve as constituent elements in a pattern of definition whereby administrative and taxpayer determination of who or what are taxable can be made by analogy and with due regard to rational consistency. It is conceivable, for example, that a definition formulated as to shoe or harness repairmen,[11] whose total tax liability, in the fiscal picture of the state, may be relatively insignificant, may in so far as the definition can be defended from attack, control, or have an important bearing upon, the theory of tax liability of building contractors[12] from whom the total tax due may be of major fiscal importance.

But the administrative technique of definition is not confined merely to formal promulgation of definitions under the rule-making power. In a state as important commercially as Illinois, the process of administrative definition is continuous and never-ending. Although formal definition may be shaped in terms of occupational grouping, individual taxpayers continuously solicit rulings as to their liability. Consistency is here the watchword. In the interests of tax policy, and without necessary regard to the opinions of the lower courts, individual rulings, upon the solicitation of individual taxpayers, must be consistent with the definitional formulations which have been publicly promulgated.

The alternative administrative procedure thus suggested raises the question whether it is more desirable to minimize the number of publicly promulgated definitions, and thereby maximize the number of individual solicitations of rulings by taxpayers, or better to elaborate the pattern of publicly promulgated general definitions. The philosophy of tax administration under the Illinois Retailers' Occupation Tax Act has been to choose the latter policy, since definition has been considered to be not only a method for resolving the initial doubts of the taxpayer as to his tax liability, but one also for stabilizing and controlling the tax assessment procedure within the Department of Finance. The most important function of administrative tax definition is its controlling force upon the internal structure of the tax agency—investigation, auditing, tax assessments, penalties, hearings. Administrative tax definition may be merely educational as it applies to the taxpayer, but, in Illinois, it is mandatory and furnishes a generative force within the tax agency for the making and enforcement of tax assessments.

Here it is necessary to contrast the judicial and administrative views as to the significance of administrative tax definition and its binding effect. Despite the fact that the Illinois Retailers' Occupation Tax Act confers upon the Department of Finance, as has been seen, the power to "make reasonable rules and regulations," an

[7] Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 47.
[8] *Id.* Rule No. 42.
[9] *Id.* Rule No. 80.
[10] *Id.* Rule No. 48.
[11] *Id.* Rule No. 13.
[12] *Id.* Rule No. 6.

administrative definition affirmatively providing for tax liability is not considered binding by most Illinois courts. The lower courts are prone to insist upon an untrammeled judicial prerogative of applying the facts of a case *de novo* to the language of the statute and arriving at independent formulations of tax liability where definitional issues are raised. The extent to which they will give binding effect to the definition of tax liability varies with the degree to which the court can exercise an expert judgment and to the extent that the court will respect the ability of the administrative officials. But definitions formulated administratively do not always affirmatively pronounce the defined occupation or event to be taxable. Several of these definitions hold that the administrative agency does not consider the defined event or occupation taxable. Whatever the views of the courts as to the affirmative formulation of taxability, there can be no question as to the binding effect of negative formulations of non-taxability. It is clear, as practical tax administration goes, that if the administrative agency formulates, by definition, a rule of non-taxability, those affected will not seek recourse to the courts to have their immunity overthrown. Since, as has been seen, administrative tax definition is mandatory internally within the tax agency, the negative definition is the outstanding responsibility of the tax administrator in consumers' taxation. The basic, ultimate and controlling function of administrative definition in Illinois is to state who are *not,* not who *are,* taxable.

In Illinois, as in most consumers' tax jurisdictions, the general consumers' tax was enacted in the midst of the last great depression as an emergency measure. For eight years, the Illinois Retailers' Occupation Tax, now seemingly a permanent and integral part of the state fiscal structure, has been administered with continuous regard to taxpayer acceptance of the tax. Definitions of taxability and non-taxability have been meticulously drafted to assure that major end. Rules embodying definitions, negative and affirmative, have accreted over eight years, as policy has unfolded and supreme court opinions have come down, into an elaborate pattern. And while, in legal effect, the consistency of two rules is not controlling as to the validity of either, consistency of all rules which, by definition, arrive at non-taxability, is a basic necessity in assuring taxpayer acceptance of continuation of this form of tax. Pertinent, therefore, is the inquiry as to whether this consistency has been achieved, and if so, how the Department of Finance has effected the feat in applying definitions to over 157,000 retailers in Illinois.

In general, the Department has premised taxability and non-taxability alike on the distinction between (1) the occupation of engaging in the business of selling tangible personal property to users or consumers in Illinois and (2) the occupation of engaging in the business of rendering services in Illinois, recognizing that where services are rendered *qua* services or in conjunction with sales of tangible personal property, there are five logical possibilities. Either a person (a) renders service and nothing else (non-taxable), or (b) sells tangible personal property and nothing else (taxable), or (c) renders services and in rendering them incidentally transfers tangible personal property, or (d) sells tangible personal property and incidentally renders

services, or (e) sells tangible personal property and renders services, both items constituting a substantial portion of the transaction. Illustratively, in reconciling to Illinois taxpayers its rulings on definitional issues under (c), (d) and (e), the Department has taken the following positions:

All persons or institutions engaged in the business of rendering services, who in the rendition of such services transfer no tangible personal property, or who transfer quantities of personal property which are entirely incidental to the *nature* of the services rendered, or inconsequential in relation to the *value* of the services rendered, do not incur tax liability under the act because not engaged in selling.[13]

When a person is engaged in the business of selling tangible personal property at retail and incidentally renders services in connection therewith, the total receipts are within the measure of the Retailers' Occupation Tax Act. Whether the service is incidental or not depends upon the nature of the business involved and the character of the commodity sold.[14]

All persons engaged in the business of rendering services who, in the rendition of such services, transfer a substantial or considerable quantity of tangible personal property are required to keep books, segregating receipts realized from services performed and those derived from the sale of such tangible personal property. Such persons incur tax liability measured by the gross receipts realized from the sale at retail of tangible personal property.[15]

Under these major conceptual formulations, there are, of course, subsumed the various propositions, which, in Illinois, are of necessity stated in terms of the "occupation" of the seller and which, in other consumers' tax jurisdictions, take the direct form of formal, definitional distinction between "sale" on the one hand and "fabrication," "lease," "rental," "license for use or consumption," *etc.*

Since the nature of the activity of the seller of tangible personal property is the touchstone of taxability in Illinois, questions as to the nature of a "sale," the nature

[13] Rendition of services: electrotypers, stereotypers and matrix makers (Rule No. 20); paper cutters (Rule No. 27); furniture and storage warehousemen (Rule No. 29); public amusement places (Rule No. 56); operators of hotels, boarding and rooming houses (Rule No. 84). Rendering of services and transference of personal property incidental to the *nature* of the services performed: correspondence schools (Rule No. 17); optometrists, oculists, opticians (Rule No. 32); hospitals, infirmaries, sanitaria (Rule No. 34); physicians and surgeons (Rule No. 52); dentists and dental laboratories (Rule No. 57); veterinarians (Rule No. 79); schools, fraternities, and sororities which operate cafeterias or restaurants for their membership (Rules No. 74, 68 and 7). Rendering services but also transferring a quantity of tangible personal property inconsequential in relation to the value of the services rendered: operators of barber and beauty shops (Rule No. 11); book binders (Rule No. 27); watch and jewelry repairmen (Rule No. 22); automobile chassis lubricators (Rule No. 31); tire and tube repairmen (Rule No. 43); automobile refinishers and painters (Rules No. 69 and 92); title abstractors (Rule No. 72); hatcheries (Rule No. 73); pest exterminators (Rule No. 80); public stenographers (Rule No. 83); advertising agencies (Rule No. 86); photostaters, blue printers, photo-finishers (Rule No. 87); pattern makers (Rule No. 93).

[14] Incidental services: newspaper, magazine and periodical publishers (Rule No. 2); contractors who sell and install fixtures (Rule No. 6); restaurants and other eating places (Rule No. 7); pharmacists and druggists (Rule No. 12); tangible personal property made to order (Rule No. 30); memorial stone and monument makers (Rule No. 42); florists and nurserymen (Rule No. 77).

[15] Funeral directors and undertakers (Rule No. 8); automobile repair shops and garages (Rule No. 10); shoe or harness repairmen (Rule No. 13); tire retreaders (Rule No. 43); picture framers, except where the picture is installed in the customer's frame (Rule No. 47); blacksmiths (Rule No. 48); fur and garment repairers (Rule No. 53); furniture repairmen and upholsterers (Rule No. 54).

of "fabrication," the nature of a "lease," *etc.*, must be recast into functional evaluation of the recipient of "receipts," *i.e.*, is such recipient a "seller" of tangible personal property at retail?[16] And since there would be no need for administrative evaluation, were there *no* tangible personal property transferred by the recipient of receipts, inclusion and exclusion is here, as almost everywhere, a question of degree. Were the administrative purpose given full effect in Illinois, it could be stated as follows:

> "Use or consumption," in addition to its usual and popular meaning, includes the employment by a person engaged in a service occupation, trade or profession, of tangible personal property in the rendering of his services where, as a necessary incident to the rendering of the service, transfer of all or of part of such tangible personal property is made from the person engaged in the service occupation, trade or profession to his customer and client. Any transfer for a consideration of property not necessary to the rendering of a service is not a "use" by the person engaged in a service occupation, but constitutes a sale at retail. "Use or consumption" also includes any disposition not for a valuable consideration of tangible personal property from one person to another.

But to offset the breadth of the formulation, there is the following *caveat:*

> "Use or consumption" shall not include any transformation, conversion, or alteration of tangible personal property in the course of a process of production whereby the tangible personal property becomes in any form part of an article which will be the subject of a "sale at retail" either by the manufacturer or by a subsequent transferee of such manufacturer.

These propositions, and others, are appeals to reason, amelioratives of rational consistency. Fundamentally, no tax is as bad as an unmitigated general consumers' tax; fundamentally, no other tax requires so greatly the tempering of the administrative process.

[16] This, of course, is not true of necessary distinctions to be drawn between "personalty" and "realty." In determining what is "tangible personal property" no specialized orientation of definition is requisite in Illinois. Thus Article 15 (the administrative definition of "tangible personal property") epitomizes the conventional. *Inter alia,* "the term 'tangible personal property' embraces all goods, wares, merchandise and commodities . . . real property consists of land and improvements to land, such as permanent buildings and all appurtenances thereto and parts thereof." The problem here is in a strict legal context.

THE TAXABLE TRANSACTION IN CONSUMERS' TAXES

Sherman P. Cohen*

Of the many problems that arise in the determination of the taxable transaction in consumers' taxes, this paper is devoted mainly to those which have reached the courts.[1] Two consumers' taxes in particular are stressed; the sales tax, and its variant, the retailers' occupation tax. The matters discussed herein will, however, find an appreciable application in most other consumers' taxes.

A typical sales tax provision provides that "a tax is hereby levied on each retail sale of tangible personal property."[2] Under such a provision, three main problems arise in the determination of the taxable transaction: First, what is a "sale"? Second, what is a "retail sale"? Third, what is "tangible personal property"? The first and third of these problems are discussed in this paper. The second problem, to which these are antecedent, is discussed in the next succeeding article.[3]

The common law has, of course, a long tradition in the definition of each of these terms. Definitions of the word "sale" are found especially in cases under the Statute of Frauds, and under the Uniform Sales Act. The tax cases have, it is true, uniformly declared that it is to the definition contained in the taxing statute, rather than to the common-law tradition, that one must first turn to determine whether a given activity is taxable. But what courts say and how they react are two different things. The ensuing discussion will reveal that the common law is still valuable as a key to judicial interpretation of the statutory definition.

The Meaning of Sale

Sale v. Service

In the law of sales a distinction is drawn between the sale of goods and the furnishing of services.[4] This distinction lies at the basis of many of the sales tax cases. While some few statutes specifically include certain limited types of services,[5]

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[1] For other discussions see Philipsborn, *Illinois Supreme Court and the Retailers' Occupation Tax* (1937) 31 Ill. L. Rev. 741, (1938) 32 *id.* 685; Note, *Applicability of the Sales Tax to Particular Transactions* (1938) 23 Wash. U. L. Q. 399; Jacoby, *Conflicting Interpretations of Retail Sales Tax Laws* (1934) 2 U. of Chi. L. Rev. 78; Haig and Shoup, The Sales Tax in the American States (1934); (1938) 51 Harv. L. Rev. 753, 11 So. Calif. L. Rev. 532.

[2] Ohio Code Ann. (Throckmorton, 1940) §5546-2.

[3] See Wahrhaftig, *Meaning of Retail Sale and Storage, Use or Other Consumption, infra* this issue.

[4] 1 Williston, Sales (2d ed. 1924) 54, 55.

[5] See W. Va. Code Ann. (Michie and Sublett, 1937) §§999(3), 999(8), 999(2) (applies to "all services except professional and personal services"); Ohio Code Ann. (Throckmorton, 1940) §5546-2

the majority either make a specific exclusion, or exclude by reason of their statutory or common-law definition of a "sale." Services which are entirely divorced from any transfer of ownership of property are, therefore, clearly not subject to the tax. The difficult problem arises in the case of those services which as an incident thereto also involve a transfer of property. The wording of the statutes is certainly broad enough to include such transfers, but both tax commissions and courts have adopted a more restricted interpretation.[6] Surely no one would contend that, when a barber shaves a person, the application of shaving soap and lotion should be taxed as a sale. Nor, on the other hand, is it contended that a deduction should be made from the sale price of gasoline purchased because of the window-wiping service of the attendant. But these are cases where the sale or the service element is merely incidental. Other cases lie in between. They are probably best approached by an analysis of specific fact situations in which the problem has arisen.

In the professions and allied groups, the doctor, the dentist, the lawyer, or the optometrist is clearly not within the statute, if no tangible property is transferred. But when the doctor puts a metal brace on a broken leg, the dentist prepares a set of false teeth, the lawyer draws an abstract of title, or the optometrist delivers a pair of glasses, one is faced with a more difficult situation. The problem is neatly presented by the dispute over the taxability of the optometrist. Illinois has held that the optometrist is not liable for any tax, as the sale of glasses, even though a factor in determining the total price, is merely incidental and necessary to the furtherance of the professional service rendered.[7] The court stressed the professional requirements of education and training,[8] and the fact that a reputation is established not because of the quality of the merchandise furnished, but rather as a result of the ability shown in the service rendered. The optometrist was compared to the physician who incidentally furnishes medicines, braces or surgical dressings, or the dentist with whom the by-product of skill is inlays and dentures.[9]

The majority of jurisdictions,[10] however, have held the optometrist taxable at least for the sale price of the glasses, though they concede that there is no tax on the professional service. It is pointed out that classification of optometry as a profession under state optometry laws does not preclude the possibility that the optometrist

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(exempts "professional, insurance, or personal service transactions which involve sales as inconsequential elements"). Because of the limited nature of the services included, these could hardly be called gross receipts taxes.

[6] Such an interpretation may run counter to uniformity clauses of some state constitutions, which, as in Winter v. Barrett, 352 Ill. 441, 186 N. E. 113 (1933), have been held to require that all persons engaged in the business of selling tangible personal property must be included in the tax.

[7] Babcock v. Nudelman, 367 Ill. 626, 12 N. E. (2d) 635 (1937).

[8] These requirements are remarkably similar to those of a master plumber; see, *e.g.*, ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 111½, §§95 *et seq.* Is the plumber, therefore, also exempt from taxation?

[9] See Berry-Kofran Dental Laboratory Co. v. Smith, 345 Mo. 922, 137 S. W. (2d) 452 (1940); Axelrod-Beacon Dental Laboratory v. City of Philadelphia, 34 D. & C. 190 (Pa. Com. Pl. 1938). Compare the common law which has held that a contract for the sale of false teeth by a dentist is a contract to sell within the Statute of Frauds. Lee v. Griffen, 1 B. & S. 272 (Ex. 1861).

[10] State Tax Comm. v. Hopkins, 234 Ala. 556, 176 So. 210 (1937); Kamp v. Johnson, 15 Cal. (2d) 187, 99 P. (2d) 274 (1940); Commonwealth v. Miller, 337 Pa. 246, 11 A. (2d) 141 (1940).

makes a "sale" under the definition in the taxing act. While some courts say the relative value of the materials, twenty per cent, to the services rendered is of no significance, it is nevertheless probably influential. The optometrist makes an actual transfer of title to tangible personal property. Such a transfer properly belongs to the occupation of the optician who is taxable,[11] and not to that of an optometrist. If the optometrist invades the optician's field of business as a vendor of merchandise, he cannot then claim immunity from the imposition of a tax merely because he happens also to be engaged in the profession of optometry.

The pharmacist in preparing prescriptions has, despite his allegations of professional character, been held taxable even in Illinois.[12] The basis of the tax is usually the total selling price of the prescription, rather than the twenty-five to fifty per cent which represents materials. This is an easier case than that of the optometrist, because of this larger proportion of property to services, and also because of the public's attitude that it is purchasing prescribed drugs rather than the service of a pharmacist. Attempts by undertakers[13] to evade a tax on the sale of caskets and shrouds because of state regulation of their business have also been unsuccessful, though they are not taxed on the service rendered.

Many other kinds of tangible personal property derive their chief value from the labor expended in their manufacture. Yet, this alone is not sufficient to create a tax exemption. The actual cost of the canvas and pigment may be infinitesimal in comparison with the value of the work wrought by a Rembrandt's genius. The cost of the yarn used in a rug may be quite negligible in comparison with the value added by the artistry of the weaver. Yet the sale of the Rembrandt or the Oriental rug is taxable, as is the manufacture of products involving a lesser labor element.[14]

While theoretically the repair trades may effect a sale of the materials used in connection with their service, the courts have taken a more practical approach. Usually they have come to consistent results. The important criteria have been two: first, the relative importance of the value of the tangible personal property ordinarily used in conjunction with this type of repair work as compared with the total charge therefor; and, second, the trade practice customarily followed, before the tax was levied, in connection with billing in that occupation. This second criterion is much preferable to one based on the practice of the particular tradesman, or the method of billing in the particular transaction, since the taxpayer should not be allowed to evade the tax by manipulating the form but not the substance of the transaction. The point has been stressed that here the work is on property belonging to another. The slight amount of new materials added by the repairman becomes a part of the

[11] See Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 32; N. Y. City Sales Tax Reg. (1939) art. 74.

[12] Wray's Pharmacy v. Lee, 199 So. 767 (Fla. 1941) (the statute included "any services which are a part of such sale"); Appeal of Biser, 317 Pa. 190, 176 Atl. 200 (1935); Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 12; see Dep't of Treasury v. Ridgely, 211 Ind. 9, 4 N. E. (2d) 557 (1936). *Cf.* Mich. Sales Tax Reg. (1940) Rule 57, which taxes only 50 per cent of the total charge, if a record of the prescription is kept.

[13] Ahern v. Nudelman, 374 Ill. 237, 29 N. E. (2d) 268 (1940); Kistner v. Iowa State Board, 225 Iowa 404, 280 N. W. 587 (1938); Commonwealth v. Dennien, 320 Pa. 257, 182 Atl. 542 (1936).

[14] See Bigsby v. Johnson, 99 P. (2d) 268 (Cal. 1940); Appeal of Biser, *supra* note 12.

customers' property not by a process of sale, but rather through the doctrine of accession.

Textile and fur cleaners, dyers and repairers, watch repairers, and laundries have all been held not to make "sales."[15] Auto repairers[16] are not taxable on transfers of paints, lubricants, or minor supplies; but they must pay the tax on sales of auto accessories and parts, where material costs are high and the trade practice in billing has consistently been to itemize labor and materials. Shoe repairing has presented a close question. The largeness of the proportion of materials to service, over thirty per cent, must be counterbalanced against the accounting difficulty of determining the amount of leather going into each repair, and the trade practice of lump sum billing. The prevailing view[17] is that the shoe repairer does make a "sale." An Iowa decision,[18] originally going to the contrary, was modified on rehearing so that as to taps and rubber heels, where the service element is small and there is competition with retail stores subject to tax, the transfer from the shoe repairer to the customer is taxable. Illinois[19] solves the bookkeeping difficulty by providing that in the absence of evidence to the contrary, tax will be collected on one-third of the total receipts from shoe-repair work.

The problem of installation charges[20] is treated a good deal like that of repair. Probably the decisive criteria are the same: the proportion of merchandise cost to services, and the trade practice followed in billing. Illinois,[21] however, taxes the installation cost only if the seller is required to install the property in order to complete the sales contract. This again presents some risk of a manipulation of form to escape taxation.

Despite conflicting common-law rules[22] as to whether or not serving food and drink in a restaurant constitutes a sale for the purpose of imposing an implied warranty of fitness, the courts[23] have held in the affirmative for the purpose of the taxing act. This is one instance where common-law decisions are of dubious value in deciding sales tax cases. Here future doctrinal developments may hold in store the reverse effect of sales tax decisions influencing the doctrine of implied warranty in restaurant cases.

[15] *In re* H. D. Kampf, Inc., 38 F. Supp. 319 (S. D. N. Y. 1941); Walter Mahon v. Nudelman, Sup. Ct. of Cook County, Ill., Nov. 8, 1940 (unreported); Marshall v. Ames, 373 Ill. 381, 26 N. E. (2d) 483 (1940); Matter of Mendoza v. Taylor, 272 N. Y. 275, 5 N. E. (2d) 818 (1936).

[16] Doby v. State Tax Comm., 234 Ala. 150, 174 So. 233 (1937).

[17] See Revsan v. Nudelman, 370 Ill. 180, 18 N. E. (2d) 219 (1938); H. H. Atkinson Co. v. State, Circuit Ct. of Wayne County, Mich., April, 1934 (unreported); Western Leather and Finding Co. v. State Tax Comm., 87 Utah 227, 48 P. (2d) 526 (1935).

[18] Sandberg Co. v. Iowa State Board, 225 Iowa 103, 278 N. W. 643 (1938), modified on rehearing, 225 Iowa 111, 281 N. W. 197 (1938).

[19] Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 13.

[20] Fifteenth Street Inv. Co. v. People, 102 Colo. 571, 81 P. (2d) 764 (1938); American Molasses Co. v. McGoldrick, 256 App. Div. 649, 11 N. Y. S. (2d) 289 (1939); Commonwealth v. Pennsylvania Heat and Power, 333 Pa. 46, 3 A. (2d) 412 (1939); Commonwealth v. Miller, 337 Pa. 246, 11 A. (2d) 141 (1940).

[21] Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 64.

[22] McCarley v. Wood Drugs, 228 Ala. 226, 153 So. 446 (1934) (no sale for warranty purposes); Greenwood v. John R. Thompson Co., 213 Ill. App. 371 (1919) (serving food does constitute a sale); 1 WILLISTON, *op. cit. supra* note 4, at 485.

[23] Pappanastos v. State Tax Comm., 235 Ala. 50, 177 So. 158 (1937); State Tax Comm. v. Burns, 236 Ala. 307, 182 So. 1 (1938); Breevort Hotel v. Ames, 360 Ill. 485, 196 N. E. 461 (1935).

The courts are sharply divided as to the applicability of the sales tax to occupations such as printing, engraving, photography, *etc.* A minority of jurisdictions, led by Illinois in *Burgess v. Ames*,[24] make a distinction between work done on special order without value to any person other than the immediate purchaser, and that done which has general commercial value. Despite the Illinois court's refusal to give weight to common-law precedents, this distinction is probably based on the Massachusetts common-law rule[25] that contracts of the former type were for labor and materials, and not for a sale. This rule was carried over into the Uniform Sales Act to exclude from the operation of the Statute of Frauds manufactured goods for which there is no market aside from the individual purchaser. The printer, the courts say, has no absolute property right capable of transfer either in the copy presented to him, or in the product when finished. If it is a lawyer's brief, the title remains in the lawyer. The small amount of paper and ink which has been transferred has had its commercial value destroyed by the printing process, and now has worth only as a brief. What the customer really pays for is not the paper and ink, but rather the skill and labor of the printer, and the use of his machinery and equipment.

That this service element is any the less important when a complicated form is printed for a limited class of the general public, as compared to a simple letterhead printed by the millions for a large corporation, is certainly not easy to demonstrate. Difficulty also occurs as to the taxability of sales of supplies to the printer[26] when even the printer does not know at the time of the purchase which of the supplies will be used for a tax-free transfer, since on special order, and which as a taxable sale, since of general commercial value. Complete exemption of the entire series of transactions from tax may be the most practical solution. These difficulties need not spread to custom-built autos or clothing,[27] unless the peculiarity of the design definitely makes them without general commercial value.

Probably the majority of jurisdictions,[28] however, hold printing and the allied arts subject to sales tax. In their judgment, the controlling factor is that the customer, even if giving a special order, desires not a service, but rather the delivery of a finished product. This factor distinguishes these cases from the professional work and repair exemptions, where the primary desire in most instances is the service, rather than the material. The proportion in value of the materials used to the service performed is of little importance, especially since it varies with the number of units

[24] 359 Ill. 427, 194 N. E. 565 (1935) (blueprinting and photostatic copying); see also Adair Printing v. Ames, 364 Ill. 342, 4 N. E. (2d) 635 (1936) (printing); A. B. C. Electrotype v. Ames, 364 Ill. 360, 4 N. E. (2d) 476 (1936) (electrotyping and stereotyping); Baker v. Tax Comm., Ohio Com. Pl., Cuyahoga County, April 4, 1940 (unreported) (printing); Washington Printing and Binding Co. v. State, 192 Wash. 448, 73 P. (2d) 1326 (1937) (printing).

[25] 1 WILLISTON, *op. cit. supra* note 4, at 50.

[26] See Acme Printing Co. v. Nudelman, 371 Ill. 217, 20 N. E. (2d) 277 (1939) (sale of ink to printer held taxable).

[27] See Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 30.

[28] Long v. Roberts & Son, 234 Ala. 520, 176 So. 213 (1937) (commercial printing; dissent on basis of the Illinois decisions); Bigsby v. Johnson, *supra* note 14 (printing); Cusick v. Commonwealth, 260 Ky. 204, 84 S. W. (2d) 14 (1935) (commercial photography); People *ex rel.* Walker Engraving Co. v. Graves, 268 N. Y. 648, 198 N. E. 539 (1935) (engraving); see Typecrafters, Inc. v. City of Philadelphia, 34 D. & C. 82 (Pa. Com. Pl. 1938).

produced. Moreover, a taxable sale has been found[29] in the transfer of engraved plates valued at not more than two per cent of the purchase price.[30]

In summary, litigation has revealed some four factors which will be considered by most courts in determining the taxability of tangible personal property transferred in conjunction with a service rendered: first, the percentage of value of the property transferred to the total charge collected; second, the primary desire of the usual purchaser in entering into the transaction, whether to obtain materials of good quality or to secure a skillful service individualized to his needs; third, the ease with which the same article, in like quantity, may be obtained from some taxable source; and fourth, the established trade practice in billing. Judgments under these criteria are difficult to make. Except under the first factor, in cases falling within the rule of *de minimis,* no one factor will itself be determinative. It is likely, furthermore, that these criteria do run counter to the tax exemption given by the minority of jurisdictions to the optometrist, and to the printer working on special orders.

Sale by Another Name

Further, there are the situations which, because of the lack of a transfer of legal title, are not, strictly speaking, "sales," but which are nevertheless specifically included in the statutes of certain states.[31] A too literal regard for this language is often unwarranted. The courts[32] have frequently held that the legislators did not mean what literally they had enacted, but rather inserted the added language to cover an attempted tax evasion by making a "sale" under some other guise.

Transactions whereby the possession of the property is transferred but the seller retains the title merely as security for payment of the selling price, are always held to be taxable as "sales."[33] "Leases and rentals" of tangible personalty are covered by some statutes expressly,[34] by others through implication,[35] and by some not at all.[36] In any jurisdiction, however, when a contract for rental, lease, or bailment is in fact a contract to sell such property, as evidenced by the fact that the lessee or bailee agreed to pay an amount substantially equivalent to the purchase price, or had the option of becoming the owner by complying with contract terms, the subterfuge will be struck aside and a tax collected.[37]

[29] People *ex rel.* Walker Engraving Co. v. Graves, *supra* note 28.

[30] A compromise solution for this class of cases is suggested by Voss v. Gray, 298 N. W. 1 (N. D. 1941). It was there held that where a photographer makes two charges—one for the sitting, whether or not the photographs are delivered, and a second if and when they are—the sales tax applies only to the latter. But where only one charge is made, or the splitting of the charge is not in good faith, the tax is applicable to the entire price.

[31] See, *e.g.,* MICH. STAT. ANN. (Henderson, 1936) §752(b); New York City Local Laws 1939, No. 101, §N41-1.0(5). The wording of these and similar statutes is discussed later.

[32] Howitt v. Street & Smith Publications, 276 N. Y. 345, 12 N. E. (2d) 435 (1938); Western Machinery Co. v. Johnson, Cal. Super. Ct., Sept. 28, 1939 (unreported); see CAL. GEN. LAWS (Deering, 1938) §8493-2(c).

[33] ILL. REV. STAT. (Bar Ass'n Ed., 1939) c. 120, §440.

[34] CAL. GEN. LAWS (Deering, 1938) §8493-2(b); W. VA. CODE ANN. (Michie and Sublett, 1937) §999(2) 4; OHIO CODE ANN. (Throckmorton, 1940) §5546-1.

[35] New York City Local Laws 1939, No. 101, §N41-1.0(5).

[36] See Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 16.

[37] *Ibid.*

Of great interest is a series of cases in New York and Pennsylvania limiting the extent of their statutory definition of "sale," which includes "any transfer of title or possession or both, . . . *license to use or consume* or otherwise, *in any manner or by any means whatsoever*."[38] In the leading case of *Howitt v. Street & Smith Publications*,[39] a publisher paid an artist a consideration for the right to reproduce sixteen of the artist's paintings on the covers of the publisher's magazines. Possession of the paintings was temporarily given to the publisher, who sent them to a photo-engraver. The court, saying that the definition was only an "attempt to cover a situation where parties might attempt to call a sale by another name," held that this right to reproduce was not a "sale." The court stressed the fact that the photo-engraver could as well have made the reproduction while the drawing was still in the artist's possession in his studio, and that the transfer of possession was therefore merely incidental. In an earlier case[40] a designer created several paper sketches which were then traced on copper rolls, and through these fabric was run for the purpose of imprinting the design on the cloth. Unlike the paintings in the *Howitt* case, the sketches became the property of the manufacturer; the transaction was accordingly held taxable as a "transfer of title and possession" rather than as a "license to use."

In *Dun & Bradstreet v. City of New York*,[41] the delivery by a credit agency to its subscribers of possession to reference books, worth possibly seventy-five per cent of the total charge, was, on motion to dismiss, held not taxable as a "license to use." The reference books were considered to be merely incidental to the rendering of a service; nor was the possession of the customer complete inasmuch as he was expected to keep the information private and return the books at the termination of the contract, or whenever a new edition was published. To achieve a dubious consistency with the *Howitt* case, the Appellate Division, in its later decision,[42] pointed out that the possession of the books need not have been transferred at all, since the subscriber could secure any of the information contained in them by a visit to the office of the credit-rating agencies. More recently,[43] the sale of books and pamphlets containing financial information, published periodically and furnished as an information service, was held subject to tax. While absence of an opinion makes judgment hazardous, the case may be distinguished from the *Dun & Bradstreet* decision since unrestricted title to these books and pamphlets probably was transferred to the subscriber.

A commercial photographer[44] by express reservation retained title to prints and graphic illustrations, but transferred the possession thereof to his customers for advertising purposes. That the substantial fee charged by the photographer was paid for the right to reproduce, rather than for the particular print or illustration, is shown

[38] N. Y. City Local Laws 1939, No. 101, §N41-1.0(5) (ital. added); Philadelphia City Laws 1938, Sales Tax Ord., §1d.

[39] 276 N. Y. 345, 12 N. E. (2d) 435 (1938).

[40] People *ex rel.* Foremost Studios v. Graves, 264 App. Div. 130, 284 N. Y. Supp. 906 (1936).

[41] 276 N. Y. 198, 11 N. E. (2d) 728 (1937) (decided on the complaint).

[42] 168 Misc. 215, 5 N. Y. S. (2d) 597 (1938) (decided on the facts proved at trial).

[43] Moody Investors Service v. McGoldrick, 280 N. Y. 581, 20 N. E. (2d) 35 (1938) (two dissents on the basis of the *Dun & Bradstreet* decision).

[44] Andersen v. City of New York, 172 Misc. 370, 15 N. Y. S. (2d) 155 (1939).

by the fact that if the print was lost, or the customer wanted another, he could secure the same for a nominal fee. On the basis of the *Howitt* case, this right to reproduce was held not to be a "license to use or consume," and therefore not taxable.[45]

In view of these New York cases restricting the "license to use" clause, the case of *United Artists Corp. v. Taylor*,[46] decided before the *Howitt* case and holding taxable a license to exhibit motion picture films, may be questionable. The case can, of course, be distinguished, since the license to exhibit, without the transfer of possession, which was for a definite period, would be valueless. A Louisiana decision,[47] with comparable statutory language to construe, felt that the *United Artists* case was still good law, despite later New York cases, and therefore reached the same result.

Under the similar Philadelphia ordinance,[48] the opinions seem to adopt the broader interpretation of "license to use." A linen supply house has been held taxable,[49] because the right to possession was necessary to the use and was transferred for a sufficient length of time to come within the *Howitt* case, even though title to the linen remained in the supply house. As to typesetters, a distinction is made, based on the person purchasing the type-metal.[50] If the printer purchases the metal, then the typesetter renders only services. If, however, the type-metal is furnished by the typesetter, and loaned on a deposit charge to the printer, though no charge is ultimately made for anything but the service in either case, then the entire transaction is deemed taxable because of the transfer of the "license to use." Even if one is to adopt the broader construction of these cases, its application may be questioned in this type of situation where no charge whatsoever is made for the so-called "license to use."

Sale for Other than Money or Profit

The courts have been almost uniform in holding that the profit motive is not essential to the creation of a taxable "sale."[51] A California decision,[52] however, has held that a social club incidentally furnishing meals to its members was not in the "business" of selling. The intervening passage of an amendment, specifically taxing club transactions, influenced this conclusion. The Pennsylvania view[53] holding clubs subject to the tax is preferable. A gas company selling gas appliances at cost in order

[45] Burgess v. Ames, 359 Ill. 427, 194 N. E. 565 (1935), more easily reached the same result with a statute not containing the "right to use" clause.

[46] 273 N. Y. 334, 7 N. E. (2d) 254 (1937).

[47] Saenger Realty Corp. v. Grosjean, 194 La. 470, 193 So. 710 (1940).

[48] Cited *supra* note 38.

[49] Philadelphia Ass'n of Linen Suppliers v. City of Philadelphia, 139 Pa. Super. 560, 12 A. (2d) 789 (1940). *Contra:* Ohio Sales Tax Reg. (1939) Rule 122.

[50] Typecrafters, Inc. v. City of Philadelphia, *supra* note 28. *Contra:* Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 36.

[51] Stone v. Rogers, 186 Miss. 53, 189 So. 810 (1939); Bay City v. State Board, 292 Mich. 241, 290 N. W. 395 (1940).

[52] Union League Club v. Johnson, 108 P. (2d) 487 (Cal. 1940).

[53] Wilson v. City of Philadelphia, 330 Pa. 342, 198 Atl. 889 (1938).

to stimulate gas consumption has been held taxable.[54] And a retailer taking merchandise from stock for his own use,[55] has also been held accountable for the sales tax, since otherwise, it is argued, he has an unfair advantage over his neighbors. If the retailer were not taxable, then the wholesaler, as to this merchandise, would be making a sale at retail; but any attempt to trace this sale back to the wholesaler would be administratively ineffective. It has also been held[56] that there is no tax on a foreclosure sale to the mortgagee under a chattel mortgage, since the sale does not transfer title, but merely extinguishes the mortgagor's equity of redemption.

Nor need a sale be for money in order to fall within the sales tax act; it need only be "for a valuable consideration." Such a consideration includes in addition to money the value of any merchandise given or service rendered in exchange for property. Barter transactions, therefore, are taxable, at least to the party engaged in business, if not to both.[57] Trade-ins are generally taxed on the basis of the allowed rather than the actual value.[58] A trifle inconsistently, food served to restaurant employees as part payment for their services is not taxable.[59] This is probably in accord with the common conception of what constitutes a sale, and administratively is a practical result; yet a logical argument could be made that the services rendered by the employees were a "valuable consideration" for which the food was transferred.

The Nature of Tangible Personal Property

The sales tax applies to the sale of "tangible personal property." Because most statutes do not contain a workable definition, the distinctions between tangible and intangible property, personalty and realty, are usually the same as those of the common law. Tangibles consist of things or substances which may be touched, felt, or observed; things that are "perceptible, palpable, capable of being possessed or realized."[60] Intangibles, which are not taxable, include shares of stock, bonds, corporate or other franchises, evidences of interest in property, evidences of indebtedness, and the like. Services, already discussed, might well be considered intangible, as well as rights to use, to consume, to reproduce, *etc.* Some few additional problems deserve special attention.

While it requires little argument to establish that electricity, gas, steam, and water are tangible within any definition of that term, much can be said for the contention that a statute referring to sales of tangible personal property is not intended to include them. It has also been questioned[61] whether the compulsory furnishing of

[54] Lee v. Jacksonville Gas Co., 138 Fla. 890, 190 So. 800 (1939).

[55] Mann v. McCaroll, 198 Ark. 628, 130 S. W. (2d) 721 (1939).

[56] Prudential Ins. Co. of America v. McGoldrick, 256 App. Div. 205, 9 N. Y. S. (2d) 515 (1939).

[57] Stone v. Rogers, *supra* note 51.

[58] Montgomery Ward & Co. v. Fry, 277 Mich. 260, 269 N. W. 166 (1936); Missouri v. Hallenberg-Wagner Motor Co., 341 Mo. 771, 108 S. W. (2d) 398 (1937); *cf.* Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 15, which taxes trade-ins only on the basis of cash actually received on later sale of property traded in. See generally, Ratchford, *The Measure of Consumption Taxes, infra* this issue.

[59] *In re* Messinger's Merchants Lunch Room, 85 F. (2d) 1002 (C. C. A. 7th, 1936); State Tax Comm. v. Burns, 236 Ala. 307, 182 So. 1 (1938).

[60] Ill. Ret. Occ. Tax Rules and Reg. (1939) art. 15.

[61] Jacoby, *supra* note 1.

such commodities at government-controlled rates to customers who have no option but to buy can properly be called a "sale" at all, as that term is commonly used. In the absence of a usual statutory provision, the courts are divided as to taxability.[62] An interesting case arose as to the sale of steam from a central heating plant.[63] If the steam is delivered to the consumer, who subsequently uses the water condensed therefrom, it was said to be taxable. But if such a transaction take the form of a delivery of heat units through a radiating system, with the steam or condensed water returning to the vendor or allowed to run down a sewer, the opposite conclusion was held to follow, probably because of the intangible nature of heat units.

Newspapers, characteristically, have felt that they should be in a specially favored class, and were, therefore, disturbed when *Bigsby v. Johnson*[64] held them subject to the sales tax. Their contention is that as they do not really sell anything tangible, but rather sell their services and convey intangible information which possesses only temporary value, they should not, therefore, be taxed. But certainly there is a transfer of tangible paper, and it has general commercial value at least for the day.

As sales taxes apply only to personal property, the sale of land, and of buildings and other permanent improvements to land, are consequently all free from taxation. But what of a case[65] where *A*, the owner of a farm, leases a gravel pit on his farm to *B*, who is building a road? Under the agreement the rental is fixed at fifteen cents per yard of gravel removed. Gravel, while in its original bed, is as much a part of the realty as the earth itself. But once separated from the land it becomes tangible personalty. When placed in the roadbed, it again reassumes its character as real property. The determination of taxability may depend on an interpretation of the terms of the agreement. If the owner is selling all of the gravel in a specified tract of land, the sale is a sale of real property, even though payment may depend on the amount of gravel removed. On the other hand, if the owner is merely agreeing to sell such gravel as may be taken from the land, or a certain number of yards of gravel at a specified price per yard, the sale is a sale of gravel when and as it is separated from the land. In the first case no tax is collectible, while in the second there is a tax, unless this be an isolated or casual sale.

In *Swain Nelson & Sons Co. v. Dep't of Finance*[66] a nurseryman unsuccessfully attempted to evade the Illinois retailers' occupation tax. He argued that trees and shrubbery are real property at the time a contract is made, and since they must be growing in the purchasers' soil before the terms of the contract are fulfilled, no

[62] People's Gas Light and Coke Co. v. Ames, 359 Ill. 112, 194 N. E. 260 (1934), held that the legislative intent was against such taxation, though later in People v. Menagas, 367 Ill. 330, 11 N. E. (2d) 403 (1937), it was held that electricity was tangible property and therefore subject to larceny. Wiseman v. Arkansas Utilities Co., 191 Ark. 854, 88 S. W. (2d) 81 (1935), declared that since the sale of natural gas was made expressly subject to the tax, sales of artificial gas were impliedly exempt, notwithstanding that the act provided that the tax applied to *all* sales of tangible personal property. Bay City v. State Board, *supra* note 51, held public utilities taxable.

[63] Detroit Edison Co. v. Fry, Circ. Ct. Wayne County, Mich., March, 1934 (unreported).

[64] *Supra* note 14.

[65] OP. ATTY. GEN. ILL. (1933) 773.

[66] 365 Ill. 401, 6 N. E. (2d) 632 (1937).

transfer of personal property takes place. The court, refusing to give any weight to common-law and Uniform Sales Act decisions, held that since the trees and shrubs are personal property when severed for transportation, title passes at that time, and there is, therefore, a sale of personal property within the taxing act.

This distinction between personalty and realty receives its most frequent application in the case of contractors. The trend today is definitely towards holding such contractors outside the scope of the sales tax.[67] The arguments made are two: First, that this is not a sales contract at all but a contract for work and materials. This is a questionable argument in view of the large material cost, and the customer's attitude that he is paying for a finished job rather than the contractor's services. Second, that the contract is not to deliver materials and fixtures as such, but rather to deliver the finished building or other structure which is realty and not personalty. By the doctrine of accession, the materials furnished, when attached to the realty, become part of the realty, and thereby lose their identity as personal property. It should not make any difference that the contract is on a time and material basis, rather than for a lump sum. The amount charged includes labor and material costs plus profits, and is the same in either case. A distinction is drawn in Illinois[68] between "materials," such as gravel and steel beams, which lose their identity in the completed structure and therefore are not taxable, and "fixtures," such as bath tubs and radiators, which do not lose their identity when installed, and therefore are taxable. This differentiation has caused endless difficulty in application and has little logical basis. The recent Illinois decision in *Materials Service Corp. v. Nudelman,*[69] now on appeal, will, if affirmed, resolve this difficulty by giving the transfer from the contractor complete exemption from the sales tax.[70]

An argument that an undertaker[71] was not selling tangible personal property, but rather was using the caskets and converting the same into real property by burial in the ground, was answered by holding that title to the caskets passed as of the date of signing the contract rather than at burial, thus making the sale one of personalty. A similar argument as to gravestones[72] was also overthrown.

[67] Lone Star Cement Co. v. State Tax Comm., 234 Ala. 465, 75 So. 699 (1937); Materials Service Corp. v. Nudelman, Circ. Ct. Cook County, Ill., Feb. 14, 1941 (appeal being taken); Herlihy Mid-Continent Co. v. Nudelman, 367 Ill. 600, 12 N. E. (2d) 638 (1938); State v. Christhilf, 170 Md. 586, 185 Atl. 456 (1936); Acorn Iron Works v. State Board, 295 Mich. 143, 295 N. W. 126 (1940); Albuquerque Lumber v. Bureau of Revenue, 45 N. M. 58, 75 P. (2d) 334 (1940).

Contra: Bradley Supply Co. v. Ames, 359 Ill. 162, 194 N. E. 272 (1935) (distinguished in the *Herlihy* case, and repudiated in the *Materials Service* case); Blome Co. v. Ames, 365 Ill. 457, 6 N. E. (2d) 841 (1937) (overruled by the *Herlihy* case); Moore v. Pleasant Harbor Const. Co., 50 Ariz. 317, 72 P. (2d) 573 (1937) (based on the *Bradley* and *Blome* cases); Wiseman v. Gillioz, 192 Ark. 950, 96 S. W. (2d) 459 (1936).

[68] See Ill. Ret. Occ. Tax Rules and Reg. (1939) Rule 6, based on Bradley Supply Co. v. Ames, *supra* note 67.

[69] *Supra* note 67.

[70] If the contractor be held not liable, is he therefore to be considered the ultimate consumer so that the sale from the material man to him is taxable as a sale at retail of tangible personal property? This and analogous problems are considered by Wahrhaftig, *supra* note 3.

[71] Kistner v. Iowa State Board, *supra* note 13.

[72] Goldstein Monument Works, Inc. v. Graves, 254 App. Div. 798, 4 N. Y. S. (2d) 241 (1938).

In conclusion a few generalizations may be made. While the wording of each statute must be carefully noted, there is a tendency for the courts to base decisions on their conception of the general nature of a sales transaction, and, therefore, to use similar reasoning even in different jurisdictions under different taxing acts. Common-law and Uniform Sales Act decisions, despite the frequent statements of the courts to the contrary, are often of value. The tendency is for the court to watch for the administrative practicability of differing solutions, whenever it does not feel too strongly one way or another. The need for revenue, in a tax originally passed as an emergency fund-raising measure, is probably considered. In addition to the inconsistencies in the same situations apparent as between jurisdictions, there is frequently little consistency within each jurisdiction in the treatment of differing fact situations. However, the sales tax is a new taxing device. It can well be expected that, as the court decisions become more numerous, they will also become more uniform in their definition of the taxable transaction.

MEANING OF RETAIL SALE AND STORAGE, USE OR OTHER CONSUMPTION

Felix S. Wahrhaftig*

Since sales taxes apply only with respect to retail sales of tangible personal property or apply at different rates with respect to retail sales and sales for resale, the principal problem of statutory construction confronting the tax administrator is that of ascertaining the factors distinguishing a retail sale from a sale for resale. The magnitude of this problem may be visualized to some extent by calling to mind the thousands of commodities sold in our markets and the great variety of uses which in innumerable instances are made of a single commodity. A determination obviously cannot be made and announced with respect to the character of the sale of each commodity for each use or purpose to which that commodity is devoted. The administrator must, therefore, consistently with the definitions appearing in his tax act, prescribe such general principles as will be determinative of the character of all sales, and implement his statements of those principles with regulations governing sales of particular commodities for particular purposes. In some cases, the character of a sale will be clearly apparent from the statement of the general principles; in others, regulations will be required as illustrations or elaborations of those principles. Ascertaining the meaning of the term "retail sale" and its use tax counterpart, "storage, use or other consumption," involves, accordingly, an examination of the general principles and their application.

Retail Sale

Aside from specific exclusions[1] or inclusions[2] effected through definition, the term "retail sale" has generally been defined along the lines of a sale of tangible personal property to a consumer or to any person for any purpose other than resale in the form of tangible personal property.[3] It is at once apparent that under this

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[1] Definitional exclusion of sales to manufacturers, made by some states, is treated *infra*. Exclusions generally, whether effected by definition of retail sale or by specific exemption from the taxable class, are analyzed by Frampton and Smith, *Commodities and Transactions Exempt From Consumption Taxes;* Conlon, *Express or Implied Exclusions From Consumption Excises—Types of Consumers*, both *infra* this issue.

[2] *E.g.*, S. D. Code (1939) §57.3101 defines retail sale as including "the sale of tickets or admissions to places of amusement or athletic contests." Many states, on the other hand, employ a selective tax on admissions rather than include such sales in their general acts.

[3] The term is defined substantially in this manner in, for example, Calif. Stats. 1941, c. 247, §2(c); Wyo. Laws 1937, c. 102, §2(e). It is defined substantially as a sale for any purpose other than for resale in, for example, Ariz. Laws 1st Sp. Sess. 1937, c. 2, §1, art. 2; N. Y. C. Administrative Code N41—1.0;

definition the controlling factor in the classification of a sale is the disposition made of the property by the purchaser and not the character of the business of the seller or the buyer[4] or the quantities in which or prices at which the property is sold.[5]

Two entirely distinct types of problems are presented by such a definition of retail sale. One arises with respect to sales to a purchaser who is engaged in the business of selling tangible personal property and involves a determination whether the property in question is purchased for use or for resale; the other involves a determination whether the purchaser is engaged in the business of selling tangible personal property within the meaning of the act. Not only are the problems wholly dissimilar, but the consequences of the rulings made in the two situations are entirely different. In problems of the former type, the ruling determines, so far at least as a retail sales tax is concerned, whether there is any tax liability with respect to the sale of the property for the purpose or use for which it is acquired. In the case of problems of the latter type, the ruling ordinarily determines, not whether any tax liability arises, but by whom the property is sold at retail within the meaning of the act and, accordingly, upon whom liability rests for the payment of the tax.

Sales to Those Engaged in Selling Tangible Personal Property

It is generally agreed that under the definition of a retail sale as one for use or consumption or for any purpose other than resale, an ingredient or component-part test should be employed in distinguishing a retail sale from a sale for resale in the case of sales of property to a firm engaged in the business of selling tangible personal property.[6] The adoption of the ingredient or component-part test is by no means, however, a final solution of the problem, for while the test appears easy to describe, it is frequently extremely difficult to apply. As the words suggest, it means nothing more than that property is not sold for resale unless it becomes a constituent part of other tangible personal property which is to be sold. It is not necessary that the property retain its separate identity in the article into which it is incorporated; it is sold for resale if the materials or elements of which it is composed actually become, in a physical sense, a part of the article to be sold. It may be clearly identifiable in that article, as in the case of buttons sold to a clothing manufacturer; it may be completely changed in form, as in the case of pulpwood sold to a manufacturer of paper; or it may be completely changed through chemical reaction, as in the case of coke sold to a manufacturer of lucite, a transparent plastic. Sales of tools, equipment, fuel and lubricants to manufacturers,[7] and sales of such equipment as showcases and cash

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and as a sale for use and consumption and not for resale in, for example, ILL. REV. STATS. (Jones, 1937) c. 120, §440; KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3602(e).

[4] Bedford v. Colorado Fuel and Iron Corp., 102 Colo. 538, 81 P. (2d) 752 (1938); Dep't of Treasury v. J. P. Michael Co., 105 Ind. App. 255, 11 N. E. (2d) 512 (1937).

[5] Wiseman v. Arkansas Wholesale Grocers' Ass'n, 192 Ark. 313, 90 S. W. (2d) 987 (1936); Franklin County Coal Co. v. Ames, 359 Ill. 178, 194 N. E. 268 (1934).

[6] While the ingredient or component part test first appeared as a matter of administrative construction, it is now set forth in the tax acts of several states, *e.g.*, Utah Laws 1939, c. 103, §2(f); Wyo. Laws 1937, c. 102, §2(f).

[7] Boyer-Campbell Co. v. Fry, 271 Mich. 282, 260 N. W. 165 (1935).

registers to retailers would clearly be retail sales in a state employing the ingredient or component-part test. It is wholly immaterial under that test that the cost of such property is an element entering into the sales price of the property sold by the manufacturers or retailers. Sales of ice for refrigeration purposes would likewise be retail sales.[8]

It is not, however, such a simple matter to apply the test to sales of feeds, seeds and fertilizer to persons engaged in the commercial production of livestock or agricultural products. In the majority of states, such sales have not been taxed as retail sales, in some cases by reason of statutory definitions or exemptions[9] and in others by reason of administrative regulations under which they are regarded as sales for resale, although in a few instances the sales have been held by regulations to be retail sales.[10] The courts, however, have generally concluded that such sales are retail sales. The Illinois supreme court has recently upheld the ruling of the administrative agency that sales of seeds to farmers were sales for use or consumption and, therefore, retail sales rather than sales for resale.[11] The reasoning of the court, from the standpoint of an application of the ingredient or component-part test, is none too clear. Its rejection of the contention that the seeds were sold for resale "because the growing plant is but a continuation of the life of the seed" and its references to the "processes of nature" as the factor responsible for the growth of the plants furnish some basis for asserting, however, that it believed that plant life was too complex a matter to warrant a determination that the elements comprising the seed entered into the growing plant to an extent which, as a matter of law, would justify regarding the seed as having been sold for resale.

The Illinois supreme court would undoubtedly regard sales of fertilizer to farmers as retail sales since it stated in the course of its rejection of the seed dealer's position in the *Sluis* case that "By the same reasoning, fertilizer placed upon the soil could be said to be used for resale because, by the chemistry of nature, it increased the crop."[12] Sales of fertilizer to farmers were held to be retail sales within the meaning of the Iowa definition of a retail sale as a "sale to a consumer or to any person for any purpose, other than for processing or for resale, of tangible personal property . . ."[13] So far as the opinion indicates, it was not contended that the fertilizer was sold for resale, but the taxpayer was unsuccessful in contending that the sale of the fertilizer was a sale for the purpose of processing.

Sales of feeds have also been held taxable as retail sales although the decisions are not clear-cut applications of the ingredient or component-part test. The tax imposed by the Oklahoma Consumers and Users Tax Act was held applicable with respect to

[8] National Ice and Cold Storage Co. v. Pacific Fruit Express Co., 11 Cal. (2d) 283, 79 P. (2d) 380 (1938); People v. Monterey County Ice and Development Co., 29 Cal. App. (2d) 421, 84 P. (2d) 1069 (1938); Warren v. Fink, 146 Kan. 716, 72 P. (2d) 968 (1937). Sales to a soda fountain of crushed ice to be placed in beverages served to customers might, however, be regarded as sales for resale.

[9] *E.g.*, Fla. Laws 1935, c. 16848, §2(f); KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3602(1); OHIO GEN. CODE ANN. (Page, 1937) §5546-2.

[10] C. C. H., Interstate Sales Tax Serv., ¶4-125.

[11] Sluis v. Nudelman, 34 N. E. (2d) 391 (Ill. 1941).

[12] *Id.* at 392.

[13] Kennedy v. State Board of Assessment and Review, 224 Iowa 405, 276 N. W. 205 (1937).

sales of feeds used for fattening cattle for market or slaughter. The state court found[14] that the sales of feeds fell within the provision of the act taxing sales "to consumers or users, for use or consumption"[15] and did not come within the provision exempting sales of property "for use in . . . processing . . . or preparing for sale" so as to become a "recognizable, integral part" of a product to be sold.[16] The Utah sales tax has also been held applicable to sales of feeds to be fed to cattle which were shortly thereafter to be slaughtered.[17] The decision lacks force from the standpoint of an application of the ingredient or component-part test, however, since a wholesale, *i.e.*, sale for resale, was defined as a sale to a person engaged in the business of manufacturing or compounding for sale, of any commodity which enters into and becomes an ingredient or component part of the property manufactured or compounded. The court stated that the words "business of manufacturing or compounding for sale" did not cover the business of farming, dairying or stock raising.

Sales of fruit trees to orchardists should clearly be regarded as retail sales under the ingredient or component-part test even in a state which by administrative regulation regards sales of seeds to farmers as sales for resale. Even though it be assumed that the seed becomes a part of the plant and is, therefore, sold for resale, the tree does not become a constituent part of the fruit but continues to exist after the fruit is picked. Sales of dairy cattle to a dairyman for use as milk producers were quite properly held to be retail sales under the California Retail Sales Tax Act,[18] and on the basis of that determination a trial court held that sales of animals for breeding purposes were retail sales under the act.[19]

If the tax act defined a retail sale as any sale except a sale for resale and defined a sale for resale as a sale of any property becoming an ingredient or component part of other tangible personal property which is to be sold, it would probably be necessary to ascertain only whether the property in question becomes a constituent part of the property to be sold. It is to be observed, however, that a retail sale is usually defined, in part, as a sale for any purpose other than resale. It would appear entirely proper under such a definition to regard as sales for resale, only sales of property purchased for the purpose of becoming and actually becoming an ingredient or component part of tangible personal property to be sold. Sales to a bakery, for example, of oil for use on the divider knives which separate the dough into individual loaves should be regarded as retail sales, even though the oil is wiped off the blades by the action of the dough and becomes a part of the bread, since it is used to keep the dough from sticking to the knives.

It is generally agreed that sales of containers such as chemical carboys and milk

[14] Colbert Mill & Feed Co. v. Okla. Tax Comm., 109 P. (2d) 504 (Okla. 1941).

[15] Okla. Laws 1937, art. 10, c. 66, §5.

[16] *Id.* §14.

[17] Salt Lake Union Stock Yards v. State Tax Comm., 93 Utah 166, 71 P. (2d) 538 (1937); Union Stock Yards v. State Tax Comm., 93 Utah 174, 71 P. (2d) 542 (1937).

[18] Kirk v. Johnson, 37 Cal. App. (2d) 224, 99 P. (2d) 279 (1940). The act, however, as amended by Cal. Stat. 1940, c. 50, exempts ". . . sales of live stock and poultry of a kind the products of which ordinarily constitute food for human consumption."

[19] Chapman Chinchilla Sales Co. v. Johnson, Prentice-Hall, Cal. State and Local Tax Serv., ¶23,029 (Sacramento County Super. Ct., 1940).

bottles to firms which retain title to and use them repeatedly in delivering tangible personal property sold to their customers are retail sales;[20] and the same is true of sales of wrapping materials sold to laundries and like firms, which are not engaged in the business of selling tangible personal property. There is a difference of opinion, however, as respects sales of containers and wrapping materials to firms which pass title to such articles on to the purchasers of the products packed in them. Sales of this character have been judicially determined to be retail sales in Alabama and Kansas,[21] principally on the grounds that the containers are purchased for use in the course of the purchaser's business, that their cost is figured as a part of the overhead of the business, and that the use of a container as a packing material destroys its economic value and is tantamount to its consumption. The sales have been held to be sales for resale, however, under the tax acts of Michigan, Florida and New York City[22] for the reason that title to the containers as well as to the property packed in them passes to the purchaser as a part of the sale.

The sale-for-resale view is believed to be correct, for the containers are a constituent part of that which is sold by the manufacturer, wholesaler or retailer and are purchased for the purpose of transfer to the customer in connection with a sale. It should be observed, however, that the resale theory breaks down in the case of sales to manufacturers of large packing cases used in shipping cartons of goods when the wholesaler purchasing from the manufacturer breaks up the cases and sells the cartons. The manufacturer can justifiably claim that he purchased both the packing cases and the smaller cartons for resale since he transferred title to both to the wholesaler. Since the wholesaler, however, sells only the cartons of goods and destroys the packing case, it would be logical to conclude that the cartons and the goods so packed are sold by the manufacturer for resale and that the packing case is sold by him at retail, but the administrative difficulties in so applying the tax would be

[20] C. C. H., Interstate Sales Tax Serv., ¶5-175.

[21] City Paper Co. v. Long, 235 Ala. 652, 180 So. 324 (1938); Durr Drug Co. v. Long, 237 Ala. 689, 188 So. 873 (1939); Birmingham Paper Co. v. Curry, 238 Ala. 138, 190 So. 86 (1939); J. R. Raible Co. v. State Tax Comm., 239 Ala. 41, 194 So. 560 (1939); Warren v. Fink, *supra* note 8.

[22] American Box Board Co. v. Stark, Prentice-Hall, Gen. State and Local Tax Serv., ¶93,008 (Kent County Circ. Ct., 1934), *appeal dismissed*, Mich. Sup. Ct., Oct. 31, 1934; Lee v. Hector Supply Co., 133 Fla. 849, 183 So. 489 (1938); American Molasses Co. v. McGoldrick, 281 N. Y. 269, 22 N. E. (2d) 369 (1939).

After holding, in Wiseman v. Arkansas Wholesale Grocers' Ass'n, *supra* note 5, that sales of wrapping materials to retailers were retail sales, the Arkansas supreme court held that sales of pasteboard boxes to a biscuit company which packed its products therein and sold the packaged products at a higher price than similar products sold in bulk were sales for resale. McCarroll v. Scott Paper Box Co., 195 Ark. 1105, 115 S. W. (2d) 839 (1938). The first decision was distinguished in the second on the ground that the company was selling a package of its products and the cost of the containers, which represented 12 to 14 per cent of the selling price of the packaged products, was added to the selling price of the biscuits, whereas in the first case it was not shown that the price of the goods sold was influenced by the cost of the materials in which they were wrapped. This distinction is believed unsound, for in both situations the cost of the packing or wrapping materials was an element in the determination of the price at which property was to be sold and it would seem immaterial whether the cost of those materials is considered separately in fixing the selling price of the property or lumped together with other expenses and the aggregate amount of the expenses considered in fixing the selling price.

insuperable. The problem is easily solved, however, as it has been in several states,[23] by defining the term "retail sale" so as to exclude sales of containers and packing or wrapping materials for use in connection with sales of tangible personal property.

The purpose factor has received judicial as well as administrative recognition. Sales of core oil to firms engaged in the business of making and selling iron castings, the function of the oil being to bind together grains of sand to form the core used to make voids or cavities in the castings, have been held to be retail sales under the Illinois Retailers' Occupation Tax Act, despite the fact it appeared that under the high temperatures at which the castings were made some of the core oil decomposed and that a portion of the carbon formed by the decomposition might have been absorbed by and become a part of the iron castings.[24] In support of its conclusion the court pointed out that the function of the core oil was to form a part of the core, that it was not purchased for the purpose of adding carbon to the castings, that if any of the carbon from the core oil was absorbed it was largely coincidental and that "Before a commodity can be said to have been resold as an ingredient of the finished product, it must be shown to have been used with the intention that it should become a part of it, and not solely for some other and distinct purpose."[25]

The foregoing discussion suggests that property may be purchased for a dual purpose, that is, for both use and resale. A manufacturer of cement, for example, purchases iron balls for use as grinding media in the milling of calcium carbonate, the balls gradually wearing away in the milling process and the iron particles entering into the cement. It is contended that a certain amount of iron is an essential constituent of cement of certain specifications, that the iron particles from the balls supply this essential element and that if sufficient iron does not enter into the cement in this manner some must be added to supply the deficiency. A statutory definition of a retail sale as a sale for use or consumption or for any purpose other than resale would not seem to warrant the view that the iron balls are necessarily sold for resale because one phase of the dual purpose for which they were acquired was their resale as an ingredient or component part of other property. It seems more reasonable to conclude that such property is sold at retail, or that the character of the sale should be determined on the basis of a finding as to the predominant purpose for which the property was acquired.

As a matter of fact, an administrator will frequently be guided by the test of predominant purpose, whether or not he adopts it as a rule of construction, since there are many instances in which the use of property is so slight as to constitute merely an incident to a subsequent resale. The mere display for advertising purposes of goods in the show windows of a retailer with no appreciable loss of value resulting from such display, or the use, in a state which regards containers as resold with their contents, of barrels for the sorting and grading of commodities that are shortly thereafter to be packed and sold in them, are illustrations of uses which the administrator

[23] *E.g.*, Colo. Laws 1937, c. 230, §2(n); Wyo. Laws 1937, c. 102, §2(f).

[24] Smith Oil & Refining Co. v. Dep't of Finance, 371 Ill. 405, 21 N. E. (2d) 292 (1939).

[25] *Id.* at 408, 21 N. E. (2d) at 294.

may deem of insufficient consequence to characterize the sales of the property in question as retail sales.

A somewhat different situation involving a dual use is presented by sales of coke to a steel foundry for use in the manufacture of castings by the cupola process, the coke being inserted in the molten metal in the course of the manufacturing process not only for the purpose of maintaining a high temperature but also for the purpose of adding carbon to the steel. One administrative agency provided by regulation that 45 per cent of the coke purchased by a foundry for use in the process would be deemed purchased for resale and the remaining 55 per cent at retail[26] on the basis of a determination that 55 per cent of the coke was consumed in maintaining the temperature of the molten metal while the rest actually entered into the metal. Assuming the correctness of the percentages employed, it cannot be denied that the ruling is fair to both the foundry and the state, much more so than would be the case if a predominant-purpose test, under which the entire amount of the coke would be regarded as sold to the foundry at retail, were applied.

It is clear from the foregoing illustrations that all sales of tangible personal property are not readily classifiable as retail sales or sales for resale within the meaning of an act defining a retail sale as a sale for use or consumption or for any purpose other than resale. These illustrations involved situations in which sales were regarded as retail sales despite the fact that the property in question became to some extent an ingredient or component part of other property. There are also, however, situations in which sales of property are regarded as sales for resale even though not all the property becomes an ingredient or component part of that which is sold. A simple illustration is the sale to a furniture manufacturer of wood to be used in the construction of furniture. A portion of the wood is destroyed or discarded and does not actually become a part of the furniture. Since the wood was purchased for the purpose of being incorporated into the furniture and, so far as possible, is used for that purpose, the fact that a small portion does not become a part of the furniture can quite justifiably be disregarded in a state employing the ingredient or component-part test.

The ingredient or component-part test as qualified by the factor of purpose appears to be consistent with the legislative intent expressed in the definition of a retail sale as a sale for use or consumption or for any purpose other than resale, and, despite the difficulties encountered in its application, seems a workable principle for distinguishing retail sales from sales for resale. While there are comparatively few judicial decisions on the matter at the present time the principle has been upheld[27] and, in all

[26] Cal. State Board of Equalization, Rule No. 9.1 (adopted June 27, 1939), Prentice-Hall, Cal. State and Local Tax Serv., ¶21,295.

[27] 4 COLO. STAT. ANN. (1935) c. 144, §2(e)(g) defined retail sale and wholesale sale, *i.e.*, sale for resale, in the usual manner, but provided that sales to manufacturers of tangible personal property which "enters into the processing of or becomes an ingredient or component part of" the product manufactured should be deemed to be wholesale sales. The Colorado supreme court held, however, that the act prescribed an ingredient or component-part test for ascertaining a retail sale, the phrase "enters into the processing of" being rather restrictively construed as meaning merely "became a constituent part of. . . ." Bedford v. Colorado Fuel and Iron Corp., *supra* note 4.

probability, will continue to obtain the approval of both the administrators and the courts.

Several states have, as a matter of policy, veered away somewhat from the ingredient or component-part test by defining retail sale so as to exclude, or wholesale sale or sale for resale to include, certain sales to manufacturers, farmers or retailers of property used in their respective operations. Other states have reached the same result by defining a retail sale in the usual manner but exempting sales to manufacturers, farmers or retailers from the application of the tax or providing that they should be taxed as sales for resale.

Shortly after the decision in the *Boyer-Campbell Co.* case[28] settled the question of the application of the Michigan General Sales Tax Act as adopted in 1933 with respect to sales of tools and machinery to manufacturers, the legislature excluded such sales from the meaning of sale at retail. The term was defined as a transaction wherein a transfer of tangible personal property is made "... for consumption or use other than for consumption or use in industrial processing or agricultural producing, or for any other purpose than for resale in the form of tangible personal property."[29] The Ohio Retail Sales Tax Act makes an even greater inroad on the ingredient or component-part test by providing that retail sales do not include sales in which the purchaser's purpose is "... to use or consume the thing transferred directly in the production of tangible personal property for sale by manufacturing, processing, refining, mining, production of crude oil and natural gas, farming, horticulture, or floriculture, or directly in making retail sales ..."[30] Under the Indiana Gross Income Tax Act, wholesale sales include:[31]

> Sales of any tangible personal property as a material which is to be directly consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, repairing, mining, agriculture, or horticulture ... Provided ... That the term "consumed" as used herein shall refer only to the immediate dissipation or expenditure by combustion, use, or application, and shall not mean or include, the obsolescence, discarding, disuse, depreciation, damage, wear, or breakage, of tools, dies, equipment, rolling stock or its accessories, machinery, or furnishings.

In a few states, the ingredient or component-part test is definitionally repudiated with respect to sales of certain designated commodities. Thus, the Wyoming Selective Sales Tax Act of 1937 provides that "Each purchase of power and/or fuel or any substitute for the same made by a person engaged in the business of manufacturing or agriculture and consumed directly in manufacturing ... shall be deemed a wholesale sale ..."[32] Iowa similarly excludes fuels used in manufacturing from the meaning of retail sale,[33] and North Carolina classifies sales to manufacturers of mill machinery and parts and accessories therefor as wholesale sales.[34] A statutory exemption exists in Alabama with respect to sales of machines, and the parts, attachments

[28] Boyer-Campbell Co. v. Fry, *supra* note 7.
[29] Mich. Pub. Acts 1935, act 77; Mich. Pub. Acts 1939, act 313.
[30] OHIO GEN. CODE ANN. (Page, 1937) §5546-1.
[31] Ind. Laws 1937, c. 117, §3.
[32] Wyo. Laws 1937, c. 102, §2(f).
[33] IOWA CODE (Reichmann, 1939) §6943.074(3).
[34] N. C. CODE (1939) §7880 (156)f.

and replacements therefor, used in mining, quarrying, compounding, processing and manufacturing tangible personal property.[35]

There are, as yet, few judicial decisions relating to the scope of these provisions. A restrictive construction has quite properly been given to the definition appearing in the Indiana act. Within the year a federal circuit court of appeals has held to be at retail, sales to a steel manufacturer of steel rolls which had a useful life, even with frequent reconditioning, of from two weeks to 12 months, and annealing boxes with an average life of 240 to 280 different heating periods of from 17 to 50 hours each in duration.[36] Sales to steel manufacturers, for lining blast furnaces, of fire brick having an average life of from 60 to 90 days had, however, been previously held to be wholesale sales.[37] The lower court so holding was of the opinion that while "the Legislature intended to limit the class of 'immediately consumed' articles to those which have a relatively short life in the manufacturing process," it did not limit such articles to those completely destroyed by combustion.

The Michigan and Ohio definitions of retail sale have been the subject of extensive regulations and supplemental rulings. In construing the Michigan definition, which excludes from the meaning of the term, sales of tangible personal property "for consumption or use in industrial processing," the administrative agency has regarded as retail sales not only sales of property for use in the various departments of a manufacturer which are considered as the "office," *e.g.*, the administrative, sales, service, advertising, accounting, traffic and purchasing departments, but also sales of property used in the "factory" other than that actually consumed in the manufacturing process or exclusively designed and made for and used in the manufacturing of a product to be sold at retail.[38] The Ohio regulation relating to property consumed in manufacturing, processing and refining divides those activities into three parts, administration, production and distribution, sales of all items to be used in administration and distribution being regarded as retail sales.[39] It is presumed that all items

[35] Ala. Gen. Acts 1939, act No. 18, §5(r).

[36] Continental Roll & Steel Foundry Co. v. Dep't of Treasury, 117 F. (2d) 196 (C. C. A. 7th, 1941).

[37] Harbison-Walker Refractories Co. v. Jackson, Prentice-Hall, Ind. State and Local Tax Serv., ¶23,027 (Marion County Super. Ct., 1939).

[38] Mich. State Board of Tax Adm'n, Rule 40 (effective February 1, 1941), Prentice-Hall, Mich. State and Local Tax Serv. ¶21,378. Sales of tools, dies, patterns and machinery used in the manufacturing process, lubricating materials, machine wiping cloths and cleaning compounds used in connection with such tools and machinery, substances used to create chemical reactions in the manufacturing process and portable heating or ventilating units, cranes, overhead hoists, hand-trucks and light globes used in the factory are not regarded as retail sales. Sales of tangible personal property to be incorporated into the factory building and which form a part of the real estate [MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b), in defining "retail sale" provides "That tangible personal property permanently affixed and becoming a structural part of real estate shall not be considered as consumed or used in industrial processing or agricultural producing"], tools, supplies and materials used in repairing or improving the factory buildings or grounds, fire extinguishers, first aid equipment and janitor's supplies are, however, held to be retail sales.

[39] Ohio Tax Dep't, Rule 39 (adopted July 11, 1939), Prentice-Hall, Ohio State and Local Tax Serv., ¶21,255. Administration, production and distribution are defined as follows:

" 'Administration' shall include all administrative work, including such work as sales promotion, general office, experimental and collection.

used exclusively in the production line and exclusively in the shop are used directly in production,[40] though sales of items deemed to be used only incidentally in production, such as time and ordinary clocks, medicine chests, janitor's supplies, fire extinguishers and drinking fountains, are regarded as retail sales.[41] As in Michigan, sales to manufacturers, processors and refiners of tangible personal property to be affixed to real property are regarded as retail sales.[42] Distinctions somewhat similar to those made in connection with manufacturing are made with respect to farming operations, articles used directly in producing or stimulating production being distinguished from articles used in storing, distributing or selling products after they have been harvested.[43] Ohio goes beyond practically all the other states that have broken away from the ingredient or component-part test by excluding from the meaning of retail sale all sales of tangible personal property used or consumed directly in making retail sales. While it is presumed that all articles used exclusively in salesrooms are used directly in the operation of making retail sales, here, again, those items used only incidentally, such as fans, clocks, fire extinguishers, and safes, and articles used in the offices, warehouses or delivery rooms of the retailer are regarded as purchased at retail.[44]

Sales to oil producers of bushings, mazda lamps, dies and other property used in the production of crude oil were judicially held[45] to be wholesale sales within the meaning of the Wyoming Emergency Sales Tax Act of 1935 which provided that[46]

> Each purchase of tangible personal property or service made by a person engaged in the business of producing, furnishing, manufacturing . . . any . . . service or commodity which is actually used in the production of, or enters into the processing of, or becomes an ingredient or component part of the . . . service, or commodity which he manufactures or . . . furnishes . . . shall be deemed a wholesale sale. . . .

The Wyoming Selective Sales Tax Act of 1937 greatly restricted the definition of a wholesale sale. It provides an ingredient or component-part test for distinguishing retail and wholesale sales, but further decrees that "Each purchase of power and/or fuel . . . made by a person engaged in the business of manufacturing or agriculture and consumed directly in manufacturing . . . shall be deemed a wholesale sale."[47] This provision has been held to embrace sales of crude oil for use as a fuel in generating electric power for distribution;[48] sales of power to be used in an oil refinery for lighting purposes;[49] and sales of natural gas for use at a field electric plant and

"'Production' shall include all operations performed in the producing, processing or refining room, shop, or plant.

"'Distribution' shall include all operations subsequent to production for sale."

[40] *Ibid.*

[41] Ohio Tax Dep't, interpretation issued June 10, 1940, *id.* ¶23,005.

[42] Note 39, *supra.*

[43] Ohio Tax Dep't, Rule 42 (adopted July 11, 1939), Prentice-Hall, Ohio State and Local Tax Serv., ¶21,261.

[44] Ohio Tax Dep't, Rule 43 (adopted July 11, 1939), *id.* ¶21,263, ¶23,005.

[45] State Board of Equalization v. Oil Wells Supply Co., 51 Wyo. 226, 65 P. (2d) 1093 (1937).

[46] Wyo. Laws 1935, c. 74, §2(f).

[47] Wyo. Laws 1937, c. 102, §2(f).

[48] State Board of Equalization v. Stanolind Oil & Gas Co., 54 Wyo. 521, 94 P. (2d) 147 (1939).

[49] *Ibid.*

for other fuel purposes in the production of petroleum products by an oil company processing natural gas to obtain casing head gasoline and a residue gas.[50]

Sales to Those Engaged in the Performance of a Service

Another phase of the problem of ascertaining the meaning of retail sale concerns sales to those engaged in activity regarded as involving the performance of a service rather than the sale of tangible personal property. The activities which have been held in some states to constitute a service fall into two classes: those in which the service is rendered in the preparation of the property furnished to the customer, as in the case of the delivery by a printer of printed materials; and those in which the service is rendered in connection with the furnishing of the property, as in the case of the furnishing of materials by a repairman in the course of his repair work. Both situations, however, present the same question of whether the activity at issue involves a sale of tangible personal property or whether the property is furnished merely as an incident to the performance of a service. The problem of differentiation is well illustrated by the conflict over the true nature of the work of the printer, photo-engraver and photographer.

It has been judicially determined under the tax acts of Illinois and Washington that a printer furnishing printed materials to the order of his customer is not engaged in the business of selling tangible personal property.[51] A similar determination has been made in Illinois with respect to the furnishing of electrotypes, stereotypes and matrices[52] and of blueprints and photostats.[53] The grounds of the holdings are that the small quantity of property furnished in these operations is destroyed and has no value to anyone other than the particular customer, that the customer really pays for skill, labor and the use of machinery and equipment, and that, in the case of printing, the business has long been recognized as a graphic art rather than as one involving the sale of property.

In Alabama and California, however, the furnishing of printed materials by a printer has been held to be a retail sale.[54] Similar determinations, moreover, have been made in New York with respect to the furnishing of photo engravings[55] and of designs to be used in the printing of fabrics,[56] and in Kentucky and North Dakota with respect to the furnishing of photographs.[57] These decisions are believed to embody the correct construction of the tax acts since the transactions unquestion-

[50] State Board of Equalization v. Argo Oil Corp., 54 Wyo. 512, 94 P. (2d) 158 (1939).

[51] H. G. Adair Printing Co. v. Ames, 364 Ill. 342, 4 N. E. (2d) 481 (1936); Washington Printing & Binding Co. v. State, 192 Wash. 448, 73 P. (2d) 1326 (1937).

[52] A. B. C. Electrotype Co. v. Ames, 364 Ill. 360, 4 N. E. (2d) 476 (1936).

[53] J. A. Burgess Co. v. Ames, 359 Ill. 427, 194 N. E. 565 (1935).

[54] Long v. Roberts & Son, 234 Ala. 570, 176 So. 213 (1937); Bigsby v. Johnson, 99 Cal. Dec. 165, 99 P. (2d) 268 (1940), rehearing granted, March 14, 1940.

[55] People *ex rel.* Walker Engraving Corp. v. Graves, 268 N. Y. 648, 198 N. E. 539 (1935). The court stated that the value of the metal in the photo engravings was not more than two per cent of what the customer pays for them.

[56] People *ex rel.* Foremost Studio, Inc. v. Graves, 246 App. Div. 130, 284 N. Y. Supp. 906 (1936).

[57] Cusick v. Commonwealth, 260 Ky. 204, 84 S. W. (2d) 14 (1935); Voss v. Gray, 298 N. W. 1 (N. D. 1941).

ably involve nongratuitous transfers of title to tangible personal property. While it may be true that the consideration charged in connection with the furnishing of the property represents largely costs of service and skill rather than costs of materials, it is nevertheless true that the customer desires not merely service, but the delivery to him of a finished product.[58]

If it is determined that a transaction is properly to be regarded as a service rather than a sale, it seems logical to conclude that there is no occasion to inquire whether the property purchased for use in the performance of that service is purchased at retail or for resale. Such a determination should be regarded as constituting in itself a finding that the sale of the property used in the performance of the service is a retail sale. The standard definition of a retail sale as a sale for use or consumption or for any purpose other than resale would appear to compel this conclusion, save where, as in a few states, sales of tangible personal property for use in the performance of a particular service are by statutory definition excluded from the meaning of the term "retail sale."[59] It would readily be conceded, for example, that sales to laundries of property used in their operations would be retail sales under the definition.

Courts, however, have not been unanimous in following the logic of the taxing pattern. The Illinois supreme court, after holding that an optometrist was not engaged in selling tangible personal property at retail within the meaning of the act when he furnished glasses to his patient,[60] ruled that the sales by an optical supply house to an optometrist of eyeglasses and other articles furnished by him to his patient were sales for resale since the optometrist did not use or consume those articles.[61] It has also held that sales of leather findings and rubber heels to a shoe repairman are not retail sales, even though it be assumed that the shoe repairman was not the retailer of those materials within the meaning of the act,[62] that sales of watch and clock repair parts to repairmen are not sales at retail,[63] and that firms manufacturing and selling medicines and pharmaceutical preparations to physicians, hospitals and sanitariums are not making retail sales.[64]

While administrators regard dentists as engaged in the performance of a service and, accordingly, as purchasing the property used in that service at retail,[65] the Mis-

[58] Judicial differentiation between sale and service is thoroughly canvassed by Cohen, *The Taxable Transaction in Consumers' Taxes, supra* this issue; for the administrative attitude see Herman, *Who Are Taxable?—Basic Problems in Definition under the Illinois Retailers' Occupation Tax Act,* also *supra* this issue.

[59] *E.g.,* "'Retail sale' and 'sale at retail' include all sales excepting those in which the purpose of the consumer is . . . (d) to use or consume the thing [transferred] directly in industrial cleaning of tangible personal property . . ." OHIO GEN. CODE ANN. (Page, 1937) §5546-1.

[60] Babcock v. Nudelman, 367 Ill. 626, 12 N. E. (2d) 635 (1937).

[61] American Optical Co. v. Nudelman, 370 Ill. 627, 19 N. E. (2d) 582 (1939).

[62] Revzan v. Nudelman, 370 Ill. 180, 18 N. E. (2d) 219 (1938).

[63] C. & E. Marshall Co. v. Ames, 373 Ill. 381, 26 N. E. (2d) 483 (1940). Although the court stated that the owner of the watch or clock is the user or consumer of the repair parts, the administrative agency, quite consistently with the Illinois decisions, has ruled that watch repairmen are deemed to be engaged in the business of rendering service and are not liable for the tax with respect to that service. Ill. Dep't Finance, Rule No. 22 (revised May 1, 1940), Prentice-Hall, Ill. State and Local Tax Serv., ¶21,535.

[64] P. H. Mallen Co., Inc. v. Dep't of Finance, 372 Ill. 598, 25 N. E. (2d) 43 (1939).

[65] C. C. H., Interstate Sales Tax Serv., ¶9-325.

souri supreme court, following the Illinois decisions, has taken the view that a dental laboratory was not selling tangible personal property at retail in making and furnishing dentures, inlays and bridgework to dentists.[66] It stated, however, that it did not have before it the question whether the transaction between the dentist and his patient was taxable. To the contrary, on the other hand, is an earlier Pennsylvania lower court opinion[67] which reasoned that since there was no retail sale from the dentist to his patient there must, therefore, be such a sale from the dental laboratory to the dentist.

The California supreme court disagrees with the Illinois view as expressed in the cases respecting optometrists, believing that the California legislature never "intended so completely to relieve from the tax the sales of any property not specifically exempted by the act."[68] It is believed that the court was entirely correct in stating that "The broad definition of the term 'retail sale' as 'a sale to a consumer or to any person for any purpose other than for resale in the form of tangible personal property' . . . leaves for construction only the question as to the person to be regarded as the retailer or as making the retail sale of the tangible personal property."[69] Nor do some other courts subscribe to the Illinois court's theory regarding the tax treatment of the repair and like trades. The Alabama supreme court first determined that while automobile repairmen were the consumers of the paint and lubricants used in their repair work, they were the retailers of the parts and accessories furnished in the course of the work;[70] and, shortly thereafter, quite consistently held[71] that sales to the repairmen of the parts of which they were regarded as retailers in the former case were sales for resale. New York's court of appeals has said that a firm engaged in the business of dyeing materials belonging to others is engaged in the performance of a service and, accordingly, purchases its dyestuffs at retail, even though the dyed materials are to be sold by its customers.[72] A similar question has been presented under the Indiana Gross Income Tax Act, with the result that a firm enameling parts sent to it by manufacturers, the enameled parts then being assembled into stoves, refrigerators and other articles by the manufacturers, was held taxable at the rate applicable to income from the performance of services, rather than at that applicable to income from wholesale sales.[73]

[66] Berry-Kofron Dental Laboratory v. Smith, 345 Mo. 922, 137 S. W. (2d) 452 (1940).

[67] Axelrod-Beacon Dental Laboratory v. City of Philadelphia, 34 D. & C. 190 (Pa. Com. Pl., 1938).

[68] Kamp v. Johnson, 15 Cal. (2d) 187, 191, 99 P. (2d) 274, 276 (1940).

[69] *Ibid.*

[70] Doby v. State Tax Comm., 234 Ala. 150, 174 So. 233 (1937).

[71] Cody v. State Tax Comm., 235 Ala. 47, 177 So. 146 (1937).

[72] Mendoza Fur Dyeing Works v. Taylor, 272 N. Y. 275, 5 N. E. (2d) 818 (1936); see *In re* H. D. Kampf, Inc., 38 F. Supp. 319 (S. D. N. Y. 1941). If it were held that the dyestuffs were sold to the dyer for resale because they entered into cloth which was to be sold, it would necessarily follow that the dyer sold the dyestuffs for resale in connection with the performance of its services. It would, then, also follow that the dyer would be selling the dyestuffs at retail if his customer intended to use rather than resell the dyed material, an obviously absurd result.

[73] Ingram-Richardson Mfg. Co. v. Dep't of Treasury, 114 F. (2d) 889 (C. C. A. 7th, 1940). While the circuit court of appeals upheld the state's position as to the question of statutory construction, it decided in favor of the taxpayer upon the ground of the invalidity of the tax under the commerce clause of the Constitution of the United States. The judgment has, however, been reversed by the Supreme Court of

Illinois maintains, on the other hand, that sales of ink to printers are retail sales.[74] This is, of course, a logical result of the holding that printers are not engaged in the business of selling tangible personal property, but it is somewhat surprising in view of the other Illinois decisions. The court reasoned that the printers are the consumers of the ink since it can never be used again. While it may be true that after ink has once been used for printing, it cannot be used again in the same sense in which leather used in repairing shoes is used thereafter for some period of time, it is difficult to understand how the two situations are distinguishable on this basis; for both the ink and the leather pass to the customers of the printer and the shoe repairman, respectively, and each serves the purpose for which it was intended so far as its use by the customer is concerned.

The question of the character of sales to contractors of the tangible personal property furnished by them in the performance of contracts for the improvement of real property warrants separate consideration, though here, too, the problem is, basically, merely one of determining whether the contractor is engaged in the business of selling tangible personal property or in the performance of a service. The problem is greatly complicated, however, both by the fact that a contractor's operations may be conducted under several different types of contracts and that in the course of such operations the tangible personal property furnished by the contractor becomes a part of real property, and by the attempts of the administrators to prescribe regulations which will not encourage avoidance of the tax but will at the same time be workable from the standpoint of ascertainment of tax liability.

The type of contract under which the contractor operated was originally regarded as determinative of the character of sales to him. If the contract required the furnishing of the specified materials and labor for a single specified sum, the contractor was regarded as engaged in the performance of a service—the improvement of real property—and the sales to him of the materials installed in the performance of that lump sum contract were held to be retail sales. If, however, the contract was written on a time and material basis, the contractor being compensated on the basis of the cost of the materials and labor furnished, the contractor was regarded as making a retail sale of the materials to the owner of the real property.

Several factors, however, indicated the desirability of a modification of this position. Contractors could easily avoid the tax through the purchase in interstate commerce of manufactured articles such as plumbing and lighting fixtures and heating and elevator equipment.[75] A manufacturer of such fixtures or equipment, by entering into lump sum rather than time and material installation contracts, could materially reduce the measure of the tax. Furthermore, as many contractors installed such fixtures and equipment under both types of contracts, a great deal of difficulty

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the United States, which agreed with the lower court on the statutory construction matter, but determined that the activity in question was not immune from taxation under the commerce clause. Dep't of Treasury v. Ingram-Richardson Mfg. Co., 61 Sup. Ct. 866 (1941).

[74] Acme Printing Ink Co. v. Nudelman, 371 Ill. 217, 20 N. E. (2d) 277 (1939).

[75] The adoption of use tax acts in 1935 and thereafter checked this type of tax avoidance.

was encountered in ascertaining their tax liability and that of their vendors. Accordingly, it is not surprising to find that the operation of the "lump sum" and "time and material" rulings was limited in some states to building materials such as cement, lumber, paint and hardware, and regulations prescribed under which contractors furnishing plumbing, heating, electrical and elevator equipment were regarded as making retail sales irrespective of the type of contract involved.

The problem is now being met in a great variety of ways. The tax acts of some states provide that sales to contractors of tangible personal property to be used in improving real property are retail sales.[76] In the absence of such statutory provisions, the type of contract under which the property is furnished by the contractor determines in many states by whom the retail sale is made. In some cases, no distinction is made between different types of property; in others, contractors furnishing plumbing, heating and other similar equipment are regarded as retailers irrespective of the type of contract. Under still another view, contractors are regarded as consumers of all materials which lose their identity to become an integral part of a building, and as retailers of property which does not lose its identity when installed.[77] In the first category would come such materials as electric wiring and connections, piping, valves and pipe fittings; in the second, lighting and heating fixtures, furnaces, air conditioning and refrigerating units and elevators. Here, too, the type of the construction contract is of no significance.

Sales to contractors of tangible personal property furnished by them in the performance of lump sum contracts for the improvement of real property have on several occasions been judicially determined to be retail sales.[78] Similar determinations have been made with respect to materials used in the performance of both lump sum and time and material contracts[79] and, in some cases, without reference to the type of contract under which the property was being furnished.[80] The principal basis of the decisions is that the contractor does not agree to transfer title to any tangible personal property, but agrees rather to improve real property or to turn over a completed structure. In other cases, however, a contractor has been regarded as the retailer of the property furnished by him in the performance of a lump sum contract.[81] The Illinois decisions respecting the liability of contractors follow the same

[76] *E.g.*, Wash. Laws 1941, c. 178; Okla. Laws 1939, c. 66, art. 11, §1(h).

[77] C. C. H., Interstate Sales Tax Serv., ¶9-025.

[78] State v. Christhilf, 170 Md. 586, 185 Atl. 456 (1936) (materials used in construction of a public road and a building); City of St. Louis v. Smith, 342 Mo. 317, 114 S. W. (2d) 1017 (1937) (materials used in construction of street pavement, a sewer and a hospital); Atlas Supply Co. v. Maxwell, 212 N. C. 624, 194 S. E. 117 (1937) (heating and plumbing equipment and supplies); Wellnitz v. Tax Comm'r, Prentice-Hall, Ohio State and Local Tax Serv., ¶23,011 (Bd. Tax Appeals, 1941) (cement building blocks).

[79] Acorn Iron Works, Inc. v. Auditor General, 295 Mich. 143, 294 N. W. 126 (1940) (structural steel).

[80] Lone Star Cement Corp. v. State Tax Comm., 234 Ala. 465, 175 So. 399 (1937) (cement); State v. J. Watts Kearney & Sons, 181 La. 554, 160 So. 77 (1934) (building materials); Albuquerque Lumber Co. v. Bureau of Revenue, 42 N. M. 58, 75 P. (2d) 334 (1937) (building materials and plumbing and heating equipment and supplies); Commonwealth v. Lutz, 284 Pa. 184, 130 Atl. 410 (1925) (plumbing equipment and supplies).

[81] Wiseman v. Gillioz, 192 Ark. 950, 96 S. W. (2d) 459 (1936) (materials used in construction of a dam, intake tower, settling basin and filtration house); Fifteenth Street Investment Corp. v. People,

pattern as the other decisions of that state respecting sales to firms engaged in the performance of a service. Although sales of plumbing and heating supplies to contractors for use in improving real property under lump sum contracts have been declared not to be retail sales,[82] it has been held that a contractor was not selling at retail the sand, gravel, concrete, steel and other materials furnished in the performance of a lump sum construction contract, the court stating that the contractors "were the persons 'using' these materials."[83] Despite this language, the circuit court of Cook County in the most recent case on the subject has held that neither the contractors nor the materialmen selling tangible personal property to them are engaged in the business of selling tangible personal property at retail within the meaning of the act.[84]

STORAGE, USE OR OTHER CONSUMPTION

Since a use tax act is adopted by a state principally for the purpose of imposing a burden equal to that of the state's sales tax with respect to property purchased outside the state or in interstate commerce, the definitions, tax levying provisions and exemptions of a use tax act are closely integrated with those of the state's sales tax act.[85] If the sales tax act provides an ingredient or component-part test for distinguishing a retail sale from a sale for resale, the use tax act will incorporate the same test in defining a taxable storage or use. If, on the other hand, the sales tax act defines retail sale so as to exclude from the meaning of the term sales of property used in industrial or agricultural production, the use tax act will by way of definition or exemption relieve property so used from the imposition of the use tax. Use tax regulations paralleling those of the state's sales tax are not necessary, as a ruling that a sale of property for a particular purpose is a retail sale also constitutes a ruling that the use of property for that purpose is a use within the meaning of the use tax act. The use tax acts do, however, present certain problems not arising with respect to sales taxes.

It is doubtful whether any purpose is now served by reference to the term "storage" in a use tax act. The term was employed in the act adopted in California in 1935 as a means of strengthening the state's position in imposing the tax with respect to property used by an instrumentality of interstate commerce, for the Supreme Court had held that while a state could not tax the use of property in inter-

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102 Colo. 571, 81 P. (2d) 764 (1938) (elevator equipment); Mason Lumber Co. v. Lee, 126 Fla. 371, 171 So. 332 (1936) (lumber and other building materials); Commonwealth v. Pennsylvania Heat & Power Co., 333 Pa. 46, 3 A. (2d) 412 (1939) (oil burners). See also Moore v. Pleasant Hasler Construction Co., 50 Ariz. 317, 72 P. (2d) 573, *rev'd*, 51 Ariz. 40, 76 P. (2d) 225 (1937) (materials used in construction of steel bridges); S. Goldstein Monument Works, Inc. v. Graves, 254 App. Div. 798, 4 N. Y. S. (2d) 241 (1938) (monuments, headstones, footstones and mausoleums).

[82] Bradley Supply Co. v. Ames, 359 Ill. 162, 194 N. E. 272 (1934).

[83] Herlihy Mid-Continent Co. v. Nudelman, 367 Ill. 600, 604, 12 N. E. (2d) 638, 640 (1937), overruling R. S. Blome Co. v. Ames, 365 Ill. 456, 6 N. E. (2d) 841 (1937), which held that a contractor was the retailer of the materials furnished in erecting and repairing buildings.

[84] Material Service Corp. v. Nudelman, Prentice-Hall, Ill. State and Local Tax Serv., ¶23,062 (Cook County Circ. Ct., 1941).

[85] Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939); Bedford v. Colorado Fuel and Iron Corp., *supra* note 4.

state commerce,[86] it might tax the storage or withdrawal from storage of property for such use.[87] Since, however, installation was regarded as a taxable use in *Pacific Telephone & Telegraph Co. v. Gallagher*,[88] the definition of use so as to include storage and installation would probably be sufficient in this regard.[89] Definition of storage as any keeping or retention in the state for any purpose except sale in the regular course of business has been modified in some states by the exclusion, as a matter of policy, of a keeping or retention in the state for subsequent use solely outside the state.[90] As between the state wherein the property is merely stored and the state of actual use, there appears to be greater justification for the imposition of the tax by the latter.

Problems arising with respect to the meaning of the term "use" generally involve the question of the circumstances under which property is purchased for use in the state within the meaning of the act. All states, by way either of statutory definition or exemption, or of administrative regulation or practice, exempt property used only temporarily in the state by a nonresident. It should logically follow that a mere temporary use of property outside the state by a resident prior to the time the property is brought to the state for use therein should not relieve the resident from the tax imposed by his state. It is difficult to generalize as to the length of time property must be used in the taxing state by the nonresident or outside the state by the resident as respects the liability of either for the tax. The Louisiana use tax was last year held applicable to the use in Louisiana of an automobile purchased in Texas by a resident of that state on March 3, 1939, and brought by the owner to Louisiana on March 15, when she came to reside there with her husband who was employed in construction operations and who expected to remain in Louisiana until the work was completed about the end of the year.[91]

There is frequently an interval of time between the date of the purchase of property and the date of its shipment to a state imposing a use tax. Whether the property was used or merely stored outside the state during that interval, the owner may claim that it was not purchased with the intent that it be used in the state to which it was shipped. In support of the tax, it may be argued that it was not the legislative intent that the owner's state of mind control the application of the tax and that his intent, so far as material, is to be inferred from the facts respecting the

[86] Helson and Randolph v. Kentucky, 279 U. S. 245 (1929).

[87] Nashville, C. & St. L. Ry. v. Wallace, 288 U. S. 249 (1933); Edelman v. Boeing Air Transport, 289 U. S. 249 (1933).

[88] 306 U. S. 182 (1939).

[89] These cases are fully discussed in terms of a query as to the future employment of use taxation, by Brown, *The Future of Use Taxes, supra* this issue.

[90] *E.g.*, Cal. Stats. 1941, c. 247, §2(a). The reasons for such an exclusion are that the owner of the property would otherwise, at least so far as possible, ship directly to the state of use, a practice harmful to the state's warehouse operators and resulting in greater shipping costs to the owner, and that the purpose to be accomplished by the tax does not compel its application with respect to such property since local business does not in this instance require the protection afforded by a use tax and since, as a use tax is imposed merely as a complement to a sales tax, it should, like the sales tax, be imposed only once.

[91] State *ex rel.* Cooper v. Pape, 194 La. 890, 195 So. 346 (1940).

purchase and use of the property. A contractor, for example, doing business in several states, may purchase a large stock of materials for subsequent use without regard to, or even without any knowledge of, the place at which the materials may thereafter be used. To support the application of its use tax, a state wherein some portion of the property is subsequently used will probably argue somewhat along the line that the materials were purchased for use at such places as the business of the contractor might require and that when in the course of that business they were shipped to the state for use by the contractor therein, they were purchased for use in the state within the meaning of the act.[92]

Another difficult situation is presented when a firm doing business in several states purchases raw materials in one state, fabricates or manufactures those materials into a somewhat different article, and then ships the finished article to another state for use there by the firm. The use tax imposed by the latter state should logically apply to the cost to the firm of the raw materials purchased outside the state and incorporated into the fabricated or manufactured article. The fact that the property is not used in the state in the same form in which it was purchased outside the state does not necessarily mean that the use of the materials may not be taxed within the state, for it may be argued that this situation is but a parallel to that which exists when property is purchased for resale but resold in a wholly different form from that in which it was purchased.

Because one of the purposes of the use tax is the removal of a tax discrimination that would otherwise operate against local business, it has been contended that as a matter of policy the tax should not apply with respect to property ordinarily unobtainable in the state. While some of the use tax acts have acceded to this contention,[93] it has received little deference from the courts. Thus, in the absence of a statutory exemption of this type, the Washington court, reversing its earlier attitude, held that state's compensating tax applicable to the use of property not manufactured or available for purchase in the state.[94] And notwithstanding the Wyoming Use Tax Act's exemption of manufacturing and mining machinery and other materials when not generally stocked for sale, or not "promptly purchaseable," in the state,[95] the supreme court of the state has ruled that the tax applies when such materials, although not generally stocked locally, can be ordered by a purchaser in the state from the Wyoming branch store of an out-of-state firm and in the ordinary course of trade shipped from the firm's home office directly to the purchaser.[96]

[92] This position has been upheld by a trial court under the California Use Tax Act. Chicago Bridge & Iron Co. v. Johnson, Prentice-Hall, Cal. State and Local Tax Serv., ¶23,018 (Sacramento County Super. Ct., 1940).

[93] See Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes*, *infra* this issue.

[94] City of Spokane v. State, 198 Wash. 682, 89 P. (2d) 826 (1939), *overruling* Pacific Telephone & Telegraph Co. v. Henneford, 195 Wash. 553, 81 P. (2d) 786 (1938).

[95] WYO. REV. STAT. (Supp. 1940) §115-2604(k).

[96] Continental Supply Co. v. People, 54 Wyo. 185, 88 P. (2d) 488 (1939). See also Scobell v. Bottum, Prentice-Hall, S. D. State and Local Tax Serv., ¶23,011 (Charles Mix County Circ. Ct., 1941).

Judicial decisions establishing the principles to be applied in determining the character of a sale or, through the process of inclusion and exclusion, fixing the line separating retail sales from sales for resale, together with statutory elaboration of definitions, are gradually imparting a definite meaning to the terms "retail sale" and "storage, use or other consumption." The fact that the definitions of those terms have not been modified to any appreciable extent through amendment, and that the amendments which have been adopted have for the most part involved merely the insertion in statutes of an administrative or judicial determination, indicates that the administrators and the courts are carrying out the intention of the legislatures as respects the meaning of the terms. That fact may also be regarded as an indication that, at least as a general rule, the terms will continue for some time to have the meanings which have been ascribed to them.

THE MEASURE OF CONSUMPTION TAXES

B. U. Ratchford*

The measure of a tax is that quantitative feature or characteristic of the tax base to which the tax rate is applied to show the amount of the tax due. The base or object of the tax is the person, property, act, or privilege upon which the tax is levied. The characteristics most frequently used as measures are: (1) monetary value or price; (2) weight; (3) volume; and (4) the number of units. Two or more of these characteristics may be used together to produce a variation in rates. For example, one state levies a sales tax of one mill on all cigarettes which sell for not more than one cent each, but the rate is 20 per cent of retail price if they sell above that figure. Similarly, the federal excise tax on the manufacture of cigarettes is based on the number of cigarettes produced but varies with the weight.

The purpose of this article is to discuss the problems which most frequently arise in connection with the concept of the measure of consumption taxes. At times it is difficult to differentiate problems affecting measure from problems of exemption, enforcement, or general administration. But since the latter are dealt with in other articles in this symposium, the discussion here will, in so far as possible, be confined exclusively to problems peculiar to the tax measure. No attempt is made to present a complete catalog of all statutory provisions and regulations in all jurisdictions. Rather, the principal effort is to describe the tax measures most generally used and to discuss the problems which have proved to be most troublesome.

Many of the particular or selective excise taxes and all general sales or transaction taxes are measured by monetary value. This is the measure which gives rise to nearly all the problems. If measurement is by weight, volume, or number of units, there is little room for misunderstanding.[1] There may be difficulty in discovering the taxable transaction or in collecting the tax, but those are problems of enforcement and not of the concept of measure. The gasoline tax provides an important exception. Problems concerned with the measure of this tax will be canvassed briefly; the remainder of the discussion will deal with consumption taxes which are measured by monetary value.

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[1] One such misunderstanding did arise in Michigan, where state law levied a tax of five cents per pound on "containers of malt syrup and malt extract." The court held that "The method of computing the poundage tax . . . is by weighing the entire contents of the containers and making no deduction for liquid ingredients." Secretary of State v. Potter, 252 Mich. 460, 465, 233 N. W. 380, 381 (1930).

THE MEASURE OF THE GASOLINE TAX

In theory the gasoline tax is a tax on the ultimate consumer. The logical point at which to levy and collect such a tax would therefore seem to be the sale for final consumption. But administrators soon found that the tax could be collected much more easily and efficiently from wholesalers, distributors, and processors. This was agreeable to the trade, since it saved much clerical work and freed retailers from worry. Consequently, all states now provide that the tax shall be collected in the early stages of distribution upon amounts received by distributors.[2] But distributors suffer losses due to shrinkage, evaporation, and wastage; it is from this physical fact that there arises the major problem in connection with the measure of the gasoline tax.

The federal tax on gasoline includes no allowance for such losses, and there appears to be no constitutional doctrine to require it. The problem presented, is, therefore, merely a question of whether and, if so, to what extent a taxing jurisdiction will recognize and make concession for these unavoidable costs in gasoline distribution. All the states save two at the present time do make such an allowance; in 36 jurisdictions it is done by statutory provision, in two it has been established by administrative ruling, in the others it is apparently allowed in practice without any formal provision.[3] Two states, Minnesota and Virginia, provide that a part of the allowance must be passed on to retailers. West Virginia alone employs the refund method of administering the deduction policy.[4] The allowance is most often stated as a percentage of the taxable gallonage, although in several states it is a percentage of the tax. While in a few instances the purpose of the deduction is not specified, it is elsewhere expressly declared to be the provision of compensation for evaporation, shrinkage, loss in handling, cost of collection, or combination of these factors. Notwithstanding the seeming clarity of purpose, Louisiana at least has experienced litigation over the meaning of the grant. The supreme court of that state declared a year ago that the legislative history of the measure clearly shows the deduction to be an allowance for "unavoidable losses in handling" and not a donation, though it conceded the tax could be levied on only 97 per cent of actual gallonage.[5] The distributor's contention had been that the statutory allowance was over and above the actual physical losses incurred, being computed, therefore, on the amounts sold, and not the amounts received, by it.[6]

The same litigation found the state seeking means to prevent distributors from taking advantage of the fixed statutory allowance, in Louisiana three per cent, where actual losses are much less. In this effort, however, the state met its second rebuff

[2] For a case upholding a provision of this kind see Standard Oil Co. v. Fitzgerald, 85 F. (2d) 799 (C. C. A. 6th, 1936).

[3] *Allowances for Cost of Collection, Shrinkage, and Evaporation—Gasoline Tax* (Fed. Tax Adm'rs, 1941) RESEARCH BULL. RB—68, at 1.

[4] *Id.* at 2-4.

[5] State v. Sinclair Refining Co., 195 La. 288, 196 So. 349 (1940); see also the earlier case of State v. Standard Oil Co., 190 La. 338, 182 So. 531 (1938).

[6] Inasmuch as the Louisiana statutory allowance referred only to losses, apparently neither distributor nor court considered that it might be regarded as one for cost of collection, leaving physical losses to be compensated to the extent actually incurred. On allowances for cost of collection, see *infra*.

at the hands of the Louisiana supreme court.[7] Just recently, in Minnesota, state constitutional provisions directed against taxation for a private purpose and irregular legislative appropriations were invoked to supplement the argument in terms of legislative intention; but with the same result.[8] This course of litigation suggests that, to the extent the statutorily-fixed percentages exceed actual experience, Illinois stands to gain by its provision allowing deduction only of actual costs, not exceeding two per cent, as do the ten states which handle the matter by administrative ruling or practice. States with a set rate of one per cent are of course not unduly disadvantaged, nor is Pennsylvania, which uses a rate that declines from two to one-half of one per cent as the amount of tax increases. But a flat two or three per cent rate is almost as common as the one per cent, while South Dakota allows four per cent.[9] Clearly, a reduction in percentage can be achieved by statutory amendment, and the 1941 sessions have seen numerous bills introduced to this end. Contrariwise, however, North Carolina has just abandoned a one per cent allowance for a 2-1½-1 per cent rate modeled on the Pennsylvania sliding-scale arrangement.[10]

ELEMENTS OF PRICE

As indicated above, monetary value is used as the measure of most consumption taxes. Provisions making the formal levy usually specify "gross receipts," "proceeds from sales," "gross sales," or "gross income" arising from sales. These all represent totals arrived at by adding up individual sales, which, in turn, represent the products of prices times number of units. In the computation of the tax, then, the starting point must be the concept of price.

Discounts

One of the first problems to arise concerns the propriety of allowing cash, trade, or quantity discounts as deductions from the list price. The usual practice is to allow any discount which in reality establishes a new selling price. Many laws specifically make such provision, while in other cases it is made by regulations or practice. The Michigan regulations state: "Cash, trade, quantity and employees' discounts are obviously used in arriving at a sales price and are deductible."[11] In Ohio, however, discounts are deductible only if taken at the time of sale.[12] The North Carolina law contains a substantially similar provision; in relation to time or credit sales, "gross sales" are defined to mean "the sales price charged on the books for such sales, without allowance for cash discounts."[13] This clause, however, is inconsistent with another section of the law which allows merchants to report and pay taxes on the basis of

[7] Cases cited *supra* note 5. In the *Sinclair* case actual losses were less than one per cent.

[8] Arneson v. W. H. Barber Co., 297 N. W. 335 (Minn. 1941) (3% allowance "much greater than the actual evaporation and loss").

[9] *Supra* note 3, at 9; CRAWFORD, THE GASOLINE TAX IN THE UNITED STATES (1936) 15, 17.

[10] N. C. H. B. No. 388, 1941.

[11] Mich. Rules and Reg. (1938) 15.

[12] Ohio Rules and Discussions (1939) 27.

[13] N. C. CODE (Michie, 1939) §7880 (156) e (9).

actual collections.[14] For if a discount is allowed it is obvious that such amount will never be collected and hence the merchant will never become liable for the tax on it.

On the other hand, the Utah regulations state that "if the price upon which the tax was computed and paid is subsequently readjusted (by discounts, rebates, bonuses, *etc.*) a proper credit may be taken against the tax due on a subsequent return."[15] The Internal Revenue Code contains a similar provision governing federal excise taxes.[16] The Washington regulations contain what is probably the clearest and fairest statement on the point; "the gross proceeds actually derived from the contract and the selling price are determined by the transaction as finally completed."[17]

The supreme court of Michigan was called upon to decide whether, in the absence of specific statutory provision, amounts represented by cash discounts were taxable.[18] The state contended that they were a part of gross receipts and, on the expense side, were a cost of doing business, which the act did not allow as a deduction. The court ruled that they were not a part of gross receipts and hence not taxable. The same rule was applied to trade and quantity discounts, the court holding:[19] ". . . the quantity discount agreements . . . do not contemplate refunds on the purchase price of merchandise, but determine the purchase price in advance of the actual sale. To hold otherwise would result in charging plaintiff more than three percent of the proceeds of the retail sales . . ." The position of the Michigan court and of the great majority of the states on discounts is sound and proper. Ohio and North Carolina have no sound justification for extending the terms "receipts" and "gross sales" so as to include amounts which retailers never receive.

Transportation, Installation, and Service Charges

Contract or quoted prices frequently include charges for transportation, installation, and service for a specified time. Where that is true, sales tax laws almost always apply to the full contract price. When stated separately such charges may or may not be taxable; in general they are exempt, but a few states look beyond form. For example, the Illinois regulations state that "whether or not transportation charges may be deducted by the seller from the selling price . . . does not depend upon the separate billing thereof but depends upon whether the seller assumes responsibility for payment of transportation charges to a designated place . . ."[20] On the other hand, the Kansas regulations exempt all such charges, regardless of the arrangement. Under use taxes, the practice is substantially the same, although Kansas, North Carolina, Oklahoma, and Washington require that transportation charges from retailer to user be included for the tax computation.

Most laws levying excise taxes prohibit the deduction of transportation charges between manufacturers or wholesalers and retailers, regardless of the place where

[14] *Id.* §7880 (156) i.

[15] Utah Reg. (1939) 26.

[16] INT. REV. CODE §3443 (a) (2).

[17] Wash. Rules and Reg. (1939) 50.

[18] Standard Oil Co. v. State, 283 Mich. 85, 276 N. W. 908 (1937).

[19] *Id.* at 91, 276 N. W. at 911.

[20] Ill. Rules and Reg. (May 28, 1940) Rev. Rule No. 25.

the title may pass.[21] California and Oklahoma, however, discriminate in favor of automobile purchasers on this point. They provide that the tax shall be based on factory or f.o.b. price plus all accessories and equipment. Most federal excise taxes are levied at the point of manufacture or production and all transportation, delivery, insurance, installation, and other like charges are excluded if they are satisfactorily separated. The selling price, however, includes "any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment."[22] Years ago the Philippine court held that where it was customary to sell hemp baled, the cost of baling was a part of the price and was subject to an excise tax measured by the "actual selling price" of hemp.[23]

Interest and Carrying Charges

The sales tax laws or regulations of at least five states—California, Colorado, Kansas, Oklahoma, and Washington—provide that interest and carrying charges will not be considered as part of the taxable price if they are separately stated. The North Carolina regulations make the same provision only for furniture stores. By court ruling, the Philippine sales tax does not apply to interest received on installment payments when title to the goods sold passed at time of sale.[24] What the practice may be in other jurisdictions is not indicated, although it is probable that it follows a similar pattern.

In some lines of business, such as furniture and jewelry, where time or instalment sales are the rule, it is customary to quote credit or time prices and allow discounts for cash. To avail themselves of the above provisions, merchants would have to make a definite allocation of selling prices to cost of article and carrying charges. In lines where both gross profit margins and carrying charges are large it would appear that merchants, in the absence of close and efficient supervision, could reduce their tax liability considerably by ascribing most of their gross profit margins to carrying charges. Perhaps it was to guard against this contingency that the regulations in Kansas, Oklahoma, and Washington require the charges to be billed separately to the customer. The Washington ruling adds that "amounts added to the base price . . . on account of failure of the buyer to make any payment at the time specified in the agreement . . . are a part of the selling price and subject to the Retail Sales Tax."[25]

Taxes

Typical laws and regulations applicable to sales and use taxes provide that specific excise taxes levied by the Federal Government or the state shall not be included in taxable receipts. Manufacturers' excise taxes, however, are not usually deductible and

[21] *Cf.* Gee Coal Co. v. Department of Finance, 361 Ill. 293, 197 N. E. 871 (1936); State v. Menefee Motor Co., 18 La. App. 694, 139 So. 61 (1932).

[22] INT. REV. CODE §3441.

[23] Inchausti & Co. v. Cromwell, 20 Philippine 345 (1911).

[24] Bachrach Motor Co. v. Posados, 53 Philippine 999 (1929).

[25] Wash. Rules and Reg. (1939) 51.

some states provide that no taxes shall be deducted unless they are paid directly by the person or firm making the return. California requires proof that the sales tax has not been absorbed.

The Michigan court has ruled that the federal tax on gasoline is a tax on the retail sale and that it and the state sales tax attach at the instant the sale is made; consequently, "the federal tax has not become a part of the sale price, but is a fund, which when collected is payable by the manufacturer to the federal government. Such fund does not become a part of the 'gross proceeds' realized by the manufacturer from the sale . . ."[26] The Illinois court, however, has held that the federal gasoline tax and other similar taxes are a part of the cost of the property sold by retailers and must be included as a part of the selling price.[27] This apparent conflict is evidently due to the fact that in the Michigan case the firm which paid the federal tax was the same one which made the retail sale, while in the Illinois case there was first a sale to a retailer who then sold to the consumer. The Michigan regulations of 1939 rule that only those who pay the tax directly to the Federal Government may deduct it; others may not, since "they are not collecting such amount from the customer as a tax, but are merely reimbursing themselves for a tax which they have previously been required to pay."[28] This position gives a slight advantage to the integrated oil company which sells directly to consumers.

The New York court has held that New York City may not, for its sales tax, require the inclusion in gross receipts of the amount of the state gasoline tax. The court stated that the gasoline tax was definitely on the purchaser and that the state enabling act did not, "either by express language or manifest intention, authorize the imposition upon the purchaser of double taxation, that is, a tax upon a tax."[29] Most sales tax laws exempt the sale of gasoline and other commodities which bear heavy excise taxes.

With regard to their own sales taxes, North Carolina and Michigan, and perhaps other states, use what is known as the 103 per cent formula. That formula assumes that merchants pass the tax on to consumers as required by law. Gross receipts are then considered as 103 per cent of taxable receipts and the tax is paid on 100 per cent. Illinois has perhaps gone as far as has any state in restricting deductions of the state sales tax itself. The regulations point out that the tax is on retailers and not on consumers; that retailers may shift the tax either by stating it separately or by including it in the quoted price, but "Regardless of how the retailer may set up his selling price he is required to pay a tax measured by his gross receipts."[30] Thus, if a merchant adds three cents to a dollar article his taxable gross receipts will be a dollar and three cents.

In federal practice, the Bureau of Internal Revenue ruled, with respect to excise

[26] Standard Oil Co. v. State, *supra* note 18, at 95-96, 276 N. W. at 912.

[27] People v. Werner, 364 Ill. 594, 5 N. E. (2d) 238 (1936).

[28] Mich. Rules and Reg. (1938) 14.

[29] Socony-Vacuum Oil Co. v. City of New York, 247 App. Div. 163, 166, 287 N. Y. Supp. 288, 291, *aff'd*, 272 N. Y. 668, 5 N. E. (2d) 385 (1936).

[30] Ill. Rules and Reg. (1939) art. 20.

taxes levied by the Revenue Act of 1918, that the tax might be deducted from the selling price if it were separately stated. In a case involving this point the Supreme Court refused to allow a refund where the tax had not been so segregated, and, by implication, cast doubt on the Bureau's power to make such a ruling.[31] Probably as a result of this *obiter dictum* it is now provided that "there shall be excluded the amount of tax imposed . . . whether or not stated as a separate charge."[32]

On theoretical as well as practical grounds a consumption tax should not be treated as an inherent element of price. The Mississippi supreme court has had occasion to apply this view in litigation by a vendor of sand and gravel to recover the amount of sales tax on the transaction.[33] The buyer's contention that the tax was included in the stipulated purchase price was rejected on the ground that a tax is necessarily added to the price fixed by contract.

During the present year state legislatures have considered many bills to prevent a "tax on a tax." Much of this concern arises because of the announced intention of laying the tax only on the last transaction before the goods pass into the hands of the consumer. It is a commendable concern, for pyramiding should be avoided as far as possible, but it is largely futile, since only a small part of the total tax burden is represented by specific commodity taxes which can be identified and isolated.

Prices below Fair Market Price

When legislators levy a tax to be measured by price, they presumably have in mind a price to be arrived at by parties dealing at arm's length. When the tax is levied on producers or dealers in the early stages of distribution, it may be profitable for the taxpayer to organize a subsidiary to take the product at a nominal profit and then sell it to the trade at a much higher price. Such a practice is another example of the use of a fictitious personality to reduce taxes. To cover this kind of contingency the 1932 and later Revenue Acts have provided that when goods are sold at less than the fair market value the tax shall "be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner."[34]

A circuit court of appeals upheld and applied this section in a case decided in 1936. A cosmetics firm had for several years been selling its products to the trade at a fixed and established price, which was far above cost of production. It then organized a selling company which bought the products from the parent company at a fair profit and sold them to the trade at the old, established prices. The court held that the transactions were not at arm's length and allowed the Commissioner to compute the tax on the old prices.[35] Following this decision the Revenue Act of 1939

[31] Lash's Products Co. v. United States, 278 U. S. 175 (1928).

[32] INT. REV. CODE §3441 (a).

[33] Woodrich v. St. Catherine Gravel Co., 195 So. 307 (Miss. 1940).

[34] See (April 10, 1941) 1 STATE TAX REV. No. 12.

[34] Now INT. REV. CODE §3441 (b) (3).

[35] Bourjois, Inc. v. McGowan, 85 F. (2d) 510 (C. C. A. 2d, 1936). Another case, essentially similar although somewhat more involved, is Inecto, Inc. v. Higgins, 21 F. Supp. 418 (S. D. N. Y. 1937). In

added a paragraph to the section levying the cosmetics tax, defining the conditions under which transactions would, *prima facie,* not be at arm's length.[36] Incidentally, this is an example of the unfortunate tendency of the Bureau to have federal tax legislation amended to cover every particular case which arises. It was the less necessary in this instance since the original, general provision had been upheld. This practice results in long, detailed, rigid, and cumbersome laws directed at particular situations rather than general flexible provisions which can be adjusted to cover new situations as they arise.

Problems such as those described above are not likely to arise often under state laws since most of the state excise taxes are levied upon retail sales. Nevertheless, five states—Arizona, Mississippi, New Mexico, Washington, and West Virginia—have included in their sales tax laws provisions substantially similar to the federal provision. Apparently no litigation or serious interpretive problems involving them have arisen. But that states may possibly become concerned over sales below fair market value resulting from intense competition because of their effect on tax revenues, is suggested by the official designation given an anti-loss-leader bill introduced in the 1941 session of the Ohio General Assembly. It reads: "To prohibit the sale of cigarettes as 'loss-leaders' with intent to injure or to destroy competition, and to stabilize and increase collections under the cigarette tax laws."[37] However, the draftsman apparently added stabilization of tax collections merely as a possible selling point, since the Ohio cigarette tax is measured by the number of cigarettes sold and not by their price. Administrators advise, moreover, that this bill was not likely to receive serious consideration.[38]

THE COMPUTATION OF TAXABLE RECEIPTS

After determination of the selling price which is to be used in computing taxable receipts, the next step in computation of the tax is to determine the total of taxable gross receipts or gross proceeds of sales. At this stage several problems arise, some of which are now considered.

Credit Sales

As the accountant uses the term, gross receipts include credit as well as cash sales. In their sales tax laws, however, a majority of the states allow merchants who do a credit business to report on a cash basis and pay the tax as collections are received. In this way the merchant does not have to pay the tax on any part of his uncollectible accounts. In some states the privilege of reporting on a cash basis is extended to all in the law itself, while in others special permission must be obtained from administrators. In Illinois, use of the cash basis is mandatory; the law states

the latter case the district court discussed at some length the various elements to be considered in determining whether a transaction was at arm's length.

[36] INT. REV. CODE §3401.

[37] Ohio Am. S. B. No. 158, 1941.

[38] Kavanaugh, *Federal Experience with Consumption Excises, infra* this issue, states that the federal gasoline tax is based on quantitative measurement for analogous reasons. The same article also deals more fully with price determination for tax purposes in the case of intercompany sales.

that "In the case of charge and time sales the amount thereof shall be included only as and when payments are received by the seller,"[39] and the regulations hold that "credit transactions . . . do not become part of gross receipts until payments are actually received by the seller."[40] Some states restrict the privilege of deferred payment to charge accounts which extend over 60 days or more. In Kansas the privilege is not available if the credit is "covered by negotiable note or notes, or an assignable conditional-sales contract."

Several states require retailers to collect the use tax. Generally such states allow the same practice in regard to credit sales for use tax purposes as for sales tax purposes. In some states sales tax regulations are, by a general statement, extended to cover the administration of the use tax wherever applicable. Kansas and Utah, however, are exceptions. Kansas allows payment of the sales tax on a collection basis but requires payment of the use tax on a sales basis.[41] In Utah the opposite conditions prevail.[42]

The states are moving to limit or restrict the privilege of deferring the payment of the tax on credit sales. Five—California, Michigan, Ohio, Oklahoma, and Utah—, of which three originally allowed deferred payment, now require that the sales tax be paid on credit sales the same as on cash sales. The severity of this restriction is increased by the fact that only Utah allows any refund, deduction, or credit for losses or bad debts.[43] The Ohio regulations state:[44] "If the account is under paid in whole or in part by the consumer, the tax is lost to the vendor and no claim for refund of the tax will be allowed." In a recent case a Michigan taxpayer contended that the term "gross proceeds" could not logically include: (1) balances due on conditional sales; (2) deferred payments due on credit sales; and (3) amounts represented by bad debts and credit losses. The court held that the provisions of the law were plain and that the legislature had the power to define the term so as to include the above elements.[45] The Federal Government does not allow deferred payment on ordinary credit sales, but with leases, instalment sales and conditional sales, taxes become due on the payments as they are made.[46]

Sales Returns and Allowances

A large majority of sales tax laws and regulations specifically allow taxpayers to claim credit for returned goods. As none prohibits such deductions, it may be assumed that in those states where the law is silent the practice is allowed. Most states, however, limit the deduction strictly to returns wherein the full purchase price is refunded, either in cash or credit, and a few specify that the tax must be included in such refund. Some of the reasons for such a careful limitation and some problems which may arise are suggested by the California regulations. These first enumerate

[39] Ill. Stat. Ann. (Jones, 1940) §119.450.

[40] Ill. Rules and Reg. (1939) 11.

[41] Kan. Reg. and Rulings (1940) 36, 83.

[42] Utah Laws 1939, c. 103, §5; Utah Laws 1937, c. 114, §7.

[43] Utah allows credit to the vendor "for taxes paid on sales represented by that portion of an account determined to be worthless and actually charged off for income tax purposes . . ." Utah Laws 1939, c. 103, §5.

[44] Ohio Rules and Discussions (1939) 49.

[45] Gardner-White Co. v. Dunckel, 296 Mich. 225, 295 N. W. 624 (1941).

[46] INT. REV. CODE §3441 (c).

certain reasons under which the returns must be justified, providing in such event for full refund to the customer, including tax. They then continue:[47]

> Even if the full sale price is credited no deduction may be taken therefor . . . if the facts and circumstances indicate that the amount credited is an allowance for used property traded in on another purchase.
>
> If there has been a substantial use of the property and the credit is pursuant to an agreement that the full selling price would be allowed on the purchase of property of substantially greater value, or if the customer purchases other property and is charged a price greater than another person would be charged for the same or similar property, it will be presumed that the contract of sale was not rescinded and the property was "traded in."

Washington regulations are strict in regard to the time element. They provide that "If the property is not returned within ten days from the date of sale, a presumption is raised that the property returned is not returned goods but is an exchange."[48]

The laws of some states, such as Utah and Washington, are sufficiently liberal to allow credit for adjustments and allowances of less than the full sale price. The Washington regulations provide for *bona fide* refunds, credits, and allowances given "on account of defects in goods sold," while the Utah provision is that[49]

> Where any taxable article is returned to the vendor thereof for adjustment or replacement . . . and a new article given pursuant to guarantee, free or at reduced price, the tax shall be computed on the actual amount, if any, to be paid by the vendor [*sic*] for the new article.

Kansas has a substantially similar regulation, although its law contains the narrow or restricted clause above mentioned. This may be explained by the fact that Kansas is one of the few states which allow the value of property traded in at the time of sale to be deducted from the sale price. Under this condition it would make no difference whether the property accepted was treated as a return sale or as a trade-in. The *Internal Revenue Code* allows a credit against, or a refund of, excise taxes "when the price on which the tax was based is readjusted by reason of a return or repossession of the article . . . or by a bona fide discount, rebate, or allowance . . ."[50] The Federal Government and most of the states which have ruled on the point permit the deduction of refunds or credits made on returnable containers in the same manner as for returned goods.

Bad Debts

Several states have included provisions for the relief of retailers who pay taxes, voluntarily or involuntarily, on the basis of total sales and then are unable to collect some of their debts. Utah allows deductions written off for income tax purposes, while Kansas merely requires that the seller shall have written off the losses on his own books. Colorado requires that the merchant shall have written off the losses and that he be able to prove the accounts uncollectible. South Dakota, which allows payment on a collection basis only for conditional sales and lease contracts of sale, does

[47] Cal. Ruling No. 50, June 27, 1939.

[48] Wash. Rules and Reg. (1939) 50.

[49] Utah Reg. (1939) 27.

[50] INT. REV. CODE §3443 (a) (2).

not allow the deduction of losses if the retailer finances the sales himself and repossesses the goods sold. If the sales are financed through a finance company, the tax is due at the time of sale and, in the event of repossession, the vendor may deduct any losses he suffers after sale of the repossessed goods.[51]

A tenable position regarding losses on account of bad debts must take account of the state's position on credit sales. If payment of the tax on a collection basis is allowed and if a large majority of the merchants affected follow that procedure, an allowance for credit losses is of little consequence. But where immediate payment of the tax is required on all sales, the refusal to allow losses is a distinct burden on the retailer. It is true that such allowances present another problem of administration and may constitute another avenue of evasion; but inasmuch as most of the states now have income taxes the policy of allowing losses under the two taxes might be coordinated, as has been done in several states. As an aid in this direction, South Dakota requires that all claims on account of losses for the previous year be filed in the January return.[52] This should greatly simplify the administrative problem.

SPECIAL PROBLEMS OF PRICE AND GROSS RECEIPTS

In addition to the items discussed above there are certain problems affecting price, gross receipts, or both which quite often arise and which deserve some special comment. Such problems are treated briefly below.

Goods Traded in or Repossessed

In certain fields, used or second-hand goods are quite regularly accepted in part payment of new goods. The treatment of sales involving these trade-ins, as they are called, has provided a difficult problem in all states which levy sales taxes. There are three ways in which the matter may be handled. First, the value placed on the used goods may be allowed as a deduction from the sale price of the new article. Second, the sale of the new article may be taxed on its full sale price but the resale of the used goods may be exempted from the tax. Third, both sales may be fully taxable.[53] Only a few jurisdictions, including Kansas, New York City and North Dakota, use the first method, Kansas having just shifted from the second.[54] Practice is about evenly divided between the second and third methods, with most of the Western states favoring the latter. While Iowa exempts the resale only to the extent of the trade-in allowance, most states using the second method exclude the sale regardless of the price. It is common with them, however, to make such exclusion only when the used goods were taken in exchange for *new* goods. For each new car that an automobile dealer sells he may have to sell two or three used cars, taking other used cars as part payment for them.[55] The North Carolina court has ruled that the resale

[51] S. D. Rules and Reg. (1939) 28. [52] *Id.* at 17.

[53] Apparently in the absence of any special provision both sales are fully taxable. State v. Hallenberg-Wagner Motor Co., 341 Mo. 771, 108 S. W. (2d) 398 (1937); City of Philadelphia v. Heinel Motors, 16 A. (2d) 761 (Pa. Super. Ct. 1940); Bedford v. Hartman Bros., 104 Colo. 190, 89 P. (2d) 584 (1939).

[54] Kan. S. B. No. 270, 1941, amending KAN. REV. STAT. (Corrick, Supp. 1939) 79-3602(h).

[55] The South Dakota supreme court has taken judicial notice of the fact that it is frequently necessary

exemption does not apply to the sale of used cars accepted in the sale of other used cars.[56]

There seems to be a general tendency for states to switch to the third method, probably as the result of unsatisfactory experience with other methods. This tightening up of provisions is, no doubt, the more attractive to administrators because it increases yields at the same time that it reduces administrative problems. Litigation indicates that in the doctrines of neither statutory nor constitutional interpretation can the taxpayer find relief from such legislative action. Only a few months ago the "double taxation" contention was unequivocably disposed of by a Pennsylvania court in these words:[57]

> Appellant contends that the effect of the decision of the court below is to impose double taxation. We find no merit in this contention. The tax is imposed on the purchaser, computed on the amount he has agreed to pay. The dealer is not required to pay any tax, since the ordinance only imposes on him the duty to collect from the purchaser, nor is the dealer required to pay any tax on the purchase of the new automobile acquired by it in the transaction since it has purchased the same for resale. When the defendant corporation proceeds to sell the car accepted by it in trade to a new purchaser, the latter enters into a totally distinct and separate transaction and is chargeable under the ordinance with the tax on the purchase made by him. In each instance, the tax has been levied upon the particular transaction with the respective purchaser.

Earlier, the Colorado supreme court had added that "there is no limit to the number of times a particular article of merchandise may be subject to a sales tax so long as it remains in the stream of commerce and goes through the regular channels of trade . . ."[58] Similarly, the South Dakota supreme court has held that a sales tax law making both the sale of new goods and the resale of used goods fully taxable is not discriminatory against automobile dealers merely because their cash receipts are lower, in proportion to the total value of their sales, than is true with other stores.[59] Taxpayer challenge on the legislative front is, however, not necessarily so hopeless; the double tax argument has an appeal that provokes a sufficient number of bills to make the adoption of some, at least, a likelihood on the law of averages.[60]

If, as is usually professed, the primary purpose of sales taxes is to levy a tax once and only once on the final, retail sale of goods, then the first method is the one best fitted to attain that end. Under it the purchaser of each article, whether new or used, pays the tax on it. When purchasing a new article the original owner of the used

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for automobile dealers to sell 15 used cars in order to dispose of five new ones. State v. Welsh, 65 S. D. 68, 270 N. W. 852 (1936).

[56] McCanless Motors Co. v. Maxwell, 210 N. C. 725, 188 S. E. 389 (1936).

[57] City of Philadelphia v. Heinel Motors, *supra* note 53, at 764. See also State v. Hallenberg-Wagner Motor Co., *supra* note 53.

[58] Bedford v. Hartman Bros., *supra* note 53, at 194, 89 P. (2d) at 585-586.

[59] State v. Welsh, *supra* note 55. See also General Tire Co. v. Oklahoma Tax Comm., 112 P. (2d) 407 (Okla. 1941).

[60] Thus of numerous bills introduced in the 1941 legislative sessions several have been enacted. See, *e.g.*, Colo. H. B. No. 355, 1941, excluding from gross sales the fair market value of exchanged property to be sold afterwards in the usual course of the retailers' business; N. M. S. B. No. 241, 1941, which amends the state use tax to permit deduction of allowances for trade-ins from the purchase price.

article, in effect, gets, on the tax originally paid, a rebate proportional to the services still remaining in the old article. Under the second method the purchaser of the new article, in effect, pays the sales tax on the sale of the second-hand article. From a broader viewpoint this may be desirable in that it introduces an element of progression into the sales tax, assuming that those who buy new articles are from a higher income level than are those who buy used goods. The North Carolina ruling cited above, however, vitiates this by making the tax apply to the sale of third-hand goods. The third method requires the payment of the tax twice on the same article, which is contrary to the general theory of the sales tax as it has been used in this country.

When goods are repossessed under conditional sales or similar contracts, problems similar to those involving trade-ins may arise. The methods of dealing with these problems are also similar. First, the merchant may be allowed a credit or a refund equal to the tax on the unpaid balance and be required to pay a tax when the repossessed goods are resold. Second, no credit or refund may be allowed but the resale may be exempted from the tax. Third, neither credit nor exemption may be allowed. This last method requires the payment of the tax a second time on a part of the value of the article, while under the second the merchant may lose if he sells the repossessed article for less than the unpaid balance. All things considered, the first method seems to be the fairest, as it is the one most commonly used. It is equivalent to treating the repossession as a sales return, and some states have grouped the two types of transactions together.

On the contrary, however, the supreme court of Michigan has ruled that vendors may not deduct unpaid balances on repossessed goods under a statutory provision allowing the deduction of "Credits or refunds for returned goods."[61] Following this ruling, the Michigan regulations were amended to provide that "Credits or refunds for returned goods . . . cover only such goods that are voluntarily returned for full exchange and do not include repossessions or recapture of merchandise by legal process . . ."[62]

Most states allow the credit or exemption only to the original vendor; if a finance company handles the transaction it is fully taxable. An Illinois rule, however, is an exception to the position generally taken; it states that, "the finance company acts as agent for the owner of the repossessed property, and is not liable for the payment of any . . . tax with respect to the proceeds from the sales."[63]

Constructive Sales

In certain circumstances taxes which are levied upon sales are extended to cover transactions which are not sales but which are designated as such for tax purposes. The concept of "sale" is treated in other articles[64] but certain aspects of the problem are pertinent to the problem of measure. For example, under the taxes levied on

[61] Montgomery Ward and Co. v. Fry, 277 Mich. 260, 269 N. W. 166 (1936); reaffirmed in Rudolph Wurlitzer Co. v. State Board of Tax Admin., 281 Mich. 558, 275 N. W. 248 (1937).

[62] Mich. Rules and Reg. (1938) 14.

[63] Ill. Rules and Reg. (1939) Rule No. 55.

[64] Consult Herman, *Who Are Taxable?—Basic Problems in Definition under the Illinois Retailers' Occupation Tax Act;* Cohen, *The Taxable Transaction in Consumers' Taxes,* both *supra* this issue.

admissions by the Federal Government and by certain states, complimentary tickets and passes are treated as having a value equal to the price charged "to other persons for the same or similar accommodations."[65] In the same way, federal excise taxes apply to goods produced and used by the producers if they do not become ingredients of taxable products. They are taxable at the usual sale price of such goods.[66] The sales tax laws of at least six states apply to goods consumed, withdrawn for use, or given away as gifts, prizes, or premiums by retail merchants.[67] In most instances they are to be valued at the cost to the retailer.

In some states the withdrawal or use of goods has presented difficult legal problems and opened up avenues of avoidance. For example, the Michigan supreme court required the state to refund taxes paid on goods used in the operation of retail stores.[68] In North Carolina the attorney-general similarly ruled that since the tax was upon sales, such transactions, because they involved no sale, could not legally be taxed. Operators of large farms or other enterprises in the same state quite often conducted small stores in connection with such activities, thus making it possible for them to procure all of their supplies without the payment of the sales tax. In certain parts of North Carolina this constituted a serious problem of avoidance. Such enterprises are now required to pay the use tax on goods used or consumed.

Evidently the same problem has arisen in Illinois, but it has been met in a different way. Retailers are "permitted" to treat their entire purchases as made for resale, but if they do so they are liable for payment of the tax on goods used or consumed. In that case, wholesalers are not required to pay the tax on goods sold to the retailer. But "if a retailer elects not to pay the tax, he will be required to produce for the Department the name of his supplier and a statement of the value of the property used by him."[69]

Combination Sales of Goods and Services

Most sales taxes in this country are levied upon the retail sale of tangible personal property. Often, however, such property is sold in conjunction with certain services and a lump sum is charged for the whole. The problem of dividing the total price into the part charged for services and the part charged for goods is a most difficult one. Most states have attacked the problem by classifying the various callings, occupations, and professions and indicating the tax liability of each. The classifications may be grouped under three broad headings. First come businesses which are primarily engaged in rendering services, but which may incidentally sell some tangible goods. Examples of such would be barbers, dentists, laundries, and physicians. These are usually exempted from the sales tax on their principal activity, but if they should sell tangible goods as a side line they are liable for the tax. Second are those businesses which are primarily engaged in selling tangible goods, but which may render some

[65] INT. REV. CODE §1700; Okla. Laws 1937, art. 10 §5(j).
[66] INT. REV. CODE §3444.
[67] California, Colorado, Illinois, Kansas, Oklahoma, and South Dakota.
[68] Montgomery Ward and Co. v. Fry, *supra* note 61, at 269, 269 N. W. at 170.
[69] Ill. Rules and Reg. (1939) Rule No. 75.

services incidentally. Examples of this group are coal and ice dealers, florists, opticians, and photographers. These are usually subject to the tax on their total receipts, even though a part of their charges may be for services. Third are those businesses which fall between the two groups described above, and in which both services and the sale of goods play important parts. In this group fall automobile and shoe repair shops, morticians, and plumbers.

The general rule applied to this third group, which supplies most of the problems, is that if they keep separate records and make separate charges for goods and services, they are liable for the tax only on the goods sold. But often a single charge is made for both goods and services and it is almost impossible to make any accurate apportionment between the two. For example, the funeral director who makes a flat charge for a funeral would find it difficult to apportion his charge between car hire, supplies, and fee. Further, many of the units involved are small and have only the most elementary accounting systems, if any at all. To meet this situation many states have provided that such units may, in the absence of cost accounting systems, arbitrarily apportion a stated per cent of their receipts to services and the remainder to goods sold. The part of the charge representing taxable sales of goods varies from state to state. Shoe and harness repairmen are taxed on from 25 to 50 per cent of charges and morticians on from 50 to 75 per cent, with 50 per cent the more common figure. Some states are finding it easier to require such units to pay a use tax on the goods they purchase and to exempt them entirely from the sales tax.

COMPUTATION AND PAYMENT OF THE TAX

The final step in the determination of consumption taxes involves, after the above problems have been solved, the computation of the taxes due and the payment of them to the state. This computation may be affected by the exact nature of the tax. Judged according to the base of the levy, there are two principal types of consumption taxes in use among the American states; one is nominally a privilege or occupation tax on retail merchants, measured by retail sales, while the other is a tax directly on each retail sale. Under the first type the retailer, after finally determining his taxable "receipts," "proceeds," or "gross sales," applies the tax rate—usually two or three per cent—and thus finds the amount of the tax he must pay. That ends the computation unless the state allows him a discount for his work in collecting the tax. But under the second type there may be additional complications, arising from the fact that application of the tax rate to individual sales seldom results in a tax measured in even cents. Consequently, the sum of the taxes computed on individual sales will be different from the tax computed on total sales.

Computation of Tax on Single Sales or on Entire Account

In the case of charge or credit accounts, the first problem is whether to compute the tax on each individual entry or on the entire account. Ohio regulations require that the tax be computed separately on each charge of a credit account. A charge is

defined as the total sales price of goods ordered at one time.[70] On the other hand, in Kansas, "the retailer will not add the tax to each individual charge sale at retail, but will compute and separately bill the tax on the total charge account."[71] South Dakota has a similar provision. In Colorado the retailer "may assess the tax on each completed sale, or on the total sales for the day, week or month to each individual, provided that the full two per cent is collected and remitted on the account for each monthly period, plus any excess tax collected."[72]

Tax Collections v. Tax Payments

The last phrase of the above quotation suggests another problem connected with those laws which impose the tax directly on retail sales. In applying the tax to small sales most states use either tax tokens or a system of brackets or "breaking points." Those brackets will usually, if consistently applied, yield an amount greater than that given by applying the tax rate to total taxable sales. In two cases the use of tokens and the bracket system has been contested on the ground that consumers are thereby forced to pay the tax at a rate higher than that levied by law. In the token case the court held that the arrangement was "for convenience in computing the tax" and arose "out of the necessity of the case." It held further that the retailer, who was the contestant, was not injured "since the tax is paid by the purchaser."[73] In the bracket case the court held that the extra cent required by the bracket system was "itself part of the purchase price" and that "it cannot become of immediate legal concern to the consumer that the . . . retailer pays to the state but four and one-half mills . . ."[74] At least six jurisdictions specifically require that the retailer pay over to the state all taxes collected, even when they exceed the computed amount on his total sales. Thus the Colorado act states: "If any vendor shall, during any reporting period, collect as a tax an amount in excess of 2% of this total taxable sales, he shall remit to the state treasurer the full net amount of the tax herein imposed and also such excess . . ."[75] A similar provision has received judicial approval in Utah.[76]

In West Virginia especially, the operation of this type provision results in an effective tax considerably higher than the one nominally levied. The tax is imposed at the rate of two per cent, but retailers are required to collect the tax according to the following schedule: on sales below six cents, no tax; from six cents to $0.50, one cent tax; from $0.51 to $1.00, two cents tax; thereafter, one cent of tax on each fifty cents or fraction thereof. The act then provides:[77] "No profit shall accrue to any person as a result of the collection of the tax levied by this article . . . and the total of all taxes collected by such person shall be returned and remitted to the tax commis-

[70] Ohio Rules and Discussions (1939) 16.
[71] Kan. Reg. and Rulings (1940) 29.
[72] Colo. Rules and Reg. (1939) 45.
[73] Morrow v. Henneford, 182 Wash. 625, 632, 47 P. (2d) 1016, 1019 (1935).
[74] De Aryan v. Akers, 12 Cal. (2d) 781, 785, 87 P. (2d) 695, 697 (1939).
[75] COLO. STAT. ANN. (1935) c. 144, §13.
[76] W. F. Jensen Candy Co. v. State Tax Comm., 90 Utah 359, 61 P. (2d) 629 (1936).
[77] W. VA. CODE (1937) §999(5).

sioner . . ." These provisions probably give an effective tax which is nearer three than two per cent.

In the absence of specific statutory provisions, the Pennsylvania courts have held that, under the Philadelphia sales tax, "the receipt of the tax money by the vendor operates to create a constructive trust" and that the vendor is not entitled to retain any part of the tax.[78] In New York City a retailer had, by order of the Comptroller, collected sales taxes on certain sales which were legally exempt. The collections had been deposited with the city. Although a lower court ordered these returned to the retailer,[79] the New York court of appeals reversed the decision, pointing out that the consumers had paid the tax and possessed a direct remedy against the Comptroller but that the petitioner was "not entitled to have returned to it this fund in which concededly it has no beneficial interest."[80]

Discounts to Dealers

Common to both principal types of American consumption taxes is the practice of compensating producers, wholesalers, and retailers, especially the latter, who act as initial tax gatherers. The work of collecting, recording, and paying the tax monies over to tax officials imposes a considerable burden upon such parties. Shoup found that every store investigated in New York City reported a distinct increase in accounting costs because of the tax and that many estimated the extra cost at from five to ten per cent of the tax collected.[81] In an effort to reduce retailer opposition to such taxes by compensating them for their quasi-public function, several states allow deductions from the computed tax. Missouri and Oklahoma allow discounts of three per cent if the tax is paid promptly. Ohio allows a three per cent discount on prepaid tax receipts. Colorado and Louisiana allow discounts of five per cent.

The most general use of discounts is found in the administration of state cigarette taxes. Of the 24 states which levy such taxes, 20 allow discounts ranging from three to ten per cent of the taxes collected to cover costs of affixing stamps.[82] These taxes are collected by the use of stamps, which has usually proven the cheapest method of tax collection. Of all the major federal taxes, the cigarette tax has been by far the most cheaply administered. The Federal Government allows no rebate or discounts but does provide machines for attaching and canceling stamps.[83] As a general rule the costs of collecting taxes should not exceed from two to four per cent;[84] certainly anything above five per cent is excessive. Yet with cigarette taxes, which are inherently easy to administer, the states are paying out to private dealers an average of about seven and one-half per cent of collections; ordinary administrative costs must

[78] City of Philadelphia v. Heinel Motors, *supra* note 53, at 765.

[79] Kesbec v. Taylor, 253 App. Div. 353, 2 N. Y. S. (2d) 241 (1938).

[80] Kesbec v. McGoldrick, 278 N. Y. 293, 297, 16 N. E. (2d) 288, 290 (1938).

[81] Shoup, *The Experience of Retailers under New York City's Sales Tax* (1936) 30 BULL. NAT. TAX ASS'N 110.

[82] TAX SYSTEMS OF THE WORLD (8th ed. 1940) 230-231.

[83] INT. REV. CODE §2112(a)(2).

[84] For example, for the fiscal year 1939 the Michigan State Board of Tax Administration had total expenses equal to 1.98 per cent of net collections. Mich. State Bd. Tax Admin., *Ann. Rep.* (1939) 4.

be added to that. Very few discounts are allowed for the collection of other taxes, many of which are more expensive to collect than the cigarette taxes.

Further, there appears to be no relation between the amount of the tax per package and the discount allowed. It costs no more to affix a four cent stamp than to affix a two cent stamp yet the only two states which levy a four cent tax allow the maximum discount of ten per cent. The distribution of the discounts is as follows:

Tax per package of 20 cigarettes	DISCOUNTS ALLOWED								
	3%	4%	5%	6%	6¼%	7%	7½%	8%	10%
2¢..........			4	1	1		1	1	3
3¢..........	1	1	1			1	1		2
4¢..........									2

It appears that the tobacco distributors were alert when cigarette taxes were being enacted and succeeded in having liberal provisions inserted for their benefit. Once established, such provisions tend to persist. There have been some reductions in recent years, but the allowances are still far too high.[85]

[85] Discounts to dealers are treated from the point of view of tax enforcement by Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes*, *supra* this issue.

COMMODITIES AND TRANSACTIONS EXEMPT FROM CONSUMPTION TAXES

George T. Frampton* and Numa L. Smith†

In a broad sense the phrase "exemption from consumption taxes" may be used to embrace those untaxed subject matters which fall outside the scope of the taxing statute.[1] It will be used more narrowly here, however, to denote exceptions from a taxable class. Since *Winter v. Barrett*,[2] when exemptions of sales of motor fuel otherwise taxed and sales made by agricultural producers were declared invalid under a particular constitutional provision of Illinois requiring state taxation to be "uniform as to the class on which it operates," the constitutionality of consumption-tax exemptions has never been seriously questioned.[3]

General Sales and Use Taxes

Because these exemptions bear the earmarks of subsidies, which must be made up from some other source, they can be justified, not by mere legislative fiat, but only on sound economic and social grounds. It is proposed to examine them accordingly, classifying them, for convenience of treatment, on the basis of their motivation.[4] So categorized there are exemptions which (1) simplify administration of the statute; (2) mitigate regressive features of the tax; (3) obviate multiple taxation, either vertically or horizontally; or (4) arise from political or group pressure. Some of the exemptions, to be sure, resist such a classification. Many states, for example, exempt from their general sales and use taxes the sale of farm products by the farmer. Since the farmer is a powerful influence in most state legislatures, this exemption is certainly not unrelated to group or political pressure; from the standpoint of administrative convenience, moreover, it avoids the difficulty of col-

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[1] See Martin, *The Social Aspects of Tax Exemption* (1936) 183 Annals 48.

[2] 352 Ill. 441, 186 N. E. 113 (1933).

[3] Nachman v. Tax Comm'r, 233 Ala. 628, 173 So. 25 (1937); Frazier v. Tax Comm., 13 Cal. App. (2d) 720, 57 P. (2d) 1022 (1936); Jones v. Grady, 169 Md. 173, 80 Atl. 272 (1935); Notgrass Drug Co. v. State, 175 Miss. 358, 165 So. 884 (1936); Fox v. Frank, 52 Ohio App. 483, 3 N. E. (2d) 996 (1935).

To the textual statement there must be entered one caveat concerning the situation in Illinois itself. Under the constitutional provision above quoted, Ill. Const. art. 9, §1, an exemption, to be valid, seemingly requires a statutory delimitation of the taxable class. Thus, the present movement in Illinois to exempt food will, if consummated, necessitate a new law which exacts the tax only on sales of tangible, non-esculent personal property. See (1940) 26 Bull. Nat. Tax Ass'n 88-89; (1941) 19 Taxes 111.

[4] See also the classification by Shoup, *Tax Exemption* (1934) 14 Encyc. Soc. Sciences 528.

lecting a tax from thousands of small producers who have no records and who might yield less than the cost of administration.

Administrative Expediency

Some exemptions obviously increase administration burden and costs, since they necessitate a separation of non-taxable from taxable transactions. This fact alone might be enough to condemn particular exemptions, unless toleration of high costs and reduced administrative efficiency is assured by counter-balancing equities. On the other hand, administration costs which are disproportionate to the revenue raised from taxing a particular transaction, and administrative difficulty in levying the tax, might possibly justify the exemption of that transaction. The degree of importance of these factors as the *raison d'etre* of any exemption cannot be accurately ascertained; probably, they are rarely the sole motivation.

This concession to administrative expediency is perhaps best illustrated by "casual and isolated" sales, which are exempted by specific language in eight states,[5] either by an excluding definition of "engaging in business" or of a "sale at retail," or by an outright exception. Were an effort made to tax, for instance, the sale by Jones of his household furniture to Smith, it is apparent that the result would be one of administrative confusion. The increase in the number of potential taxpayers would force the various revenue offices either to employ house-to-house canvassers or to rely wholly upon the taxpayer to report the sale.

The exemption itself raises a perplexing question of construction as to what constitutes a "casual and isolated" sale. The Kansas act, stating that an "isolated or occasional sale of tangible personal property . . . by a person not engaged in such business does not constitute engaging in business, within the meaning of this act," is typical of the provisions effective in the various states. Pertinent litigation is sparse, but administrative rulings and the few cases which turn on this point indicate that the test of "engaging in business" is whether there is a "systematic recurrence and continuity" of such sales.[6] Application of the test to antipodal situations is fairly easy, as is demonstrated by the Ohio case of *State v. Zellner*,[7] in which the state supreme court refused to extend this exemption to sales of property which had been acquired by a loan company on foreclosure of chattel mortgages given as security, such sales exceeding $25,000 annually. And, in *Sioux Falls Motor Co. v. Welsh*,[8] arising under the South Dakota provision, the court of that state found that a new car dealer necessarily had to engage in the business of selling used cars, with the consequence that sales of the latter were not "casual and isolated."

[5] ARK. DIG. STAT. (Pope, 1937) §14069(b)2; ILL. REV. STAT. (Bar Ass'n ed., 1939) c. 120, §440; KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3602(k); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b); N. M. STAT. ANN. (Courtright, Supp. 1938) §141-1703(g); OHIO GEN. CODE ANN. (Page, 1937) §5546-2; S. D. CODE (1939) §57.3101(6); WASH. REV. STAT. ANN. (Remington, Supp. 1940) §8370-19(a); W. VA. CODE ANN. (Michie & Sublett, 1937) §999(2)5. OHIO GEN. CODE ANN. (Page, 1937) §5546-2(9) also exempts sales incidental to professional services.

[6] See, for example, Kan. Reg. and Rulings (1940) art. 9(b).

[7] 133 Ohio St. 263, 13 N. E. (2d) 235 (1938). [8] 65 S. D. 68, 270 N. W. 852 (1936).

But the cases arising in the twilight zone are not so easily disposed of, for ascertaining whether such sales are made often enough to be considered a part of the vendor's business cannot be done by a rule of thumb. It would seem, however, that in so far as the exemption is rested upon administrative convenience, there is little justification in labeling as "casual and isolated" a sale which is shown on the records of a vendor registered under the sales tax act. Significantly, several states apparently confine the exemption to vendors who are not engaged in the business of selling. Ohio, for example, exempts a "casual and isolated sale by a vendor not engaged in the business of selling tangible personal property."[9] A literal construction of such a clause would rule out a sale by a vendor whose business is selling, even though the article sold were unrelated to his regular business; it is probable, however, that a more liberal construction will be followed and that sales unrelated to the vendor's ordinary business of selling will be exempt.[10] Since this interpretation will itself raise additional problems of what is an unrelated sale, there might be further reason for thinking a strict construction desirable.

Another concession to administrative expediency is apparent in the exemption of sales of farm products and livestock when made by the producer. Found in no less than seven states,[11] this exemption is, of course, to a large extent also a recognition of the power of the agricultural blocs in the various state legislatures. But again there is the difficulty of enforcing the tax against vendors who keep no records and whose sales to consumers are small. Aside from the inherent trouble in deciding what are farm products,[12] this exemption disturbs the equitable principle of uniformity, since it discriminates against those vendors who sell produce which they have purchased. Unquestionably, the tax can be more easily collected from retailers and curb market operators, but it is doubtful that either the fact of production or administrative expediency is a sufficient basis for a discriminatory subsidy of direct marketing. A strict construction, either by a narrow interpretation of farm products or by emphasis on the reasons underlying the exemption, would seem desirable. The latter approach is well illustrated by *Curry v. Reeves*,[13] in which the Alabama supreme court refused to extend the exemption to a farmer-retailer who sold in his store baby chicks hatched from eggs collected on his farm. The court stated that the exemption was given to help the farmer as a farmer and that to grant it here would be to help the farmer in his position as a merchant. It may also be noted

[9] The New Mexico statute similarly defines an isolated sale as one made by a person who does not "hold himself out as engaged in business." N. M. STAT. ANN. (Courtright, Supp. 1938) §141-1703(g).

[10] Carnicom v. Tax Comm., 5 Ohio O. 348 (Com. Pl. 1936).

[11] Ala. Gen. Acts 1939, act No. 18, §5(f); ARK. DIG. STAT. (Pope, 1937) §14071; MISS. CODE ANN. (Supp. 1938) §2328; N. M. STAT. ANN. (Courtright, Supp. 1938) §141-1716; N. C. CODE ANN. (Michie, 1939) §7880(156)f; Okla. Laws 1937, c. 66. art. 11, §6(f); Wyo. Laws 1937, c. 118, §4(c) (use tax exemption). See BUEHLER, GENERAL SALES TAXATION (1932) 154; JACOBY, RETAIL SALES TAXATION (1938) 116; SALES TAXES: GENERAL, SELECTIVE, AND RETAIL (Nat. Ind. Conf. Bd., 1932) 16-18; Note (1934) 47 HARV. L. REV. 860, 864.

[12] See HAIG AND SHOUP, THE SALES TAX IN THE AMERICAN STATES (1934) 88.

[13] 195 So. 428 (Ala. 1940). That a cotton ginner cannot claim an exemption as a producer of farm products, see Frazier v. Stone, 171 Miss. 56, 156 So. 596 (1934).

that the administrative reason for the exemption is satisfied by this set of facts, as no difficulty in collecting the tax from the farmer-merchant would be involved.

Finally, an exemption based wholly on administrative convenience is that allowing tax free the use of property up to a certain amount and for a stipulated period. Although such exemption appears in the statutes of only five states,[14] it is, from an administrative standpoint, impossible to exact the tax to the last penny, even in the absence of an exempt minimum, since the cost of doing so would be prohibitive. The most that an all-out effort to enforce the use tax could bring would be a plethora of petty tax evasion. As one writer has pointed out, this exemption is a tacit admission that it is expedient to collect the tax only from the larger taxpayers.[15] In a way, therefore, this exemption is a mitigation of the regressive feature of the tax, although its motivation is decidedly not that. Of the states with the retail sales tax, only Michigan grants a flat-sum exemption.[16] Rather than a concession to administrative expediency, this exemption seems to be an effort to help the retailer defray his share of the costs of the tax.[17]

Mitigation

Few, if any, economists defend the justness of sales taxes.[18] A fixed tax of one cent on a ten-cent purchase, they point out, is unrelated to the consumer's ability to pay that cent; nor are wealthy consumers taxed a higher percentage of their outlay simply because they pay more taxes through increased purchases. Exemptions of non-luxuries or essentials in many states may be understood in the light of this criticism of consumption taxes, although other motives may have impelled their enactment. Items placed in the category of essentials or necessaries by legislative declaration include medicine[19] and students' textbooks.[20] No doubt North Carolina's exemption of the sale of coffins[21] was inserted to remove the sting from the argument that the consumer is taxed from the cradle to the grave.

[14] KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3704; MICH. COMP. LAWS (Mason, Supp. 1940) §3663-44; MISS. CODE ANN. (Supp. 1938) §2358; N. D. Laws 1939, c. 241, §3; Okla. Laws 1939, c. 66, art. 12, §5.

[15] JACOBY, *op. cit. supra* note 11, at 154.

[16] MICH. COMP. LAWS (Mason, Supp. 1940) §3663-4.

[17] See Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes*, *supra* this issue, at p. 518, n. 37.

[18] BUEHLER, at 245-246; JACOBY, at 85, both *op. cit. supra* note 11; HAIG AND SHOUP, *op. cit. supra* note 12, at 8. But contrast Pierce, *The Place of Consumption Excises in the Tax System*, *supra* this issue.

[19] N. C. CODE ANN. (Michie, 1939) §7880(156)f(k).

[20] Ala. Gen. Acts 1939, act No. 18, §5(d); IOWA CODE (Reichmann, 1939) §6943.076(4), as interpreted by REP. ATTY. GEN. (Iowa 1938) 601; MICH. COMP. LAWS (Mason, Supp. 1940) §3663-4a(d); MISS. CODE ANN. (Supp. 1938) §2328(1); N. C. CODE ANN. (Michie, 1939) §7880 (156)f(g); N. D. Laws 1937, c. 249, §3(e); N. M. STATS. ANN. (Courtwright, Supp. 1938) §141-1716(e); W. VA. CODE ANN. (Michie & Sublett, 1937) §999(9)3. For judicial comment on the desirability of the schoolbook exemption, see Notgrass Drug Co. v. State, *supra* note 3, at 366, 165 So. at 885. North Carolina also exempts the sales of Holy Bibles. N. C. Pub. Laws 1941, c. 158, §406(g).

[21] N. C. CODE ANN. (Michie, 1939) §7880(156)f(o). In the absence of an express exemption, the sale of a casket is a taxable sale of tangible personal property and is not a part of a contract for service. Kistner v. Iowa State Board, 225 Iowa 404, 280 N. W. 587 (1938). Neither is it a sale of realty or a sale incidental to a professional service. Ahern v. Nudelman, 374 Ill. 237, 29 N. E. (2d) 268 (1940).

But by far the most important of this type of exemption is that favoring food or food products. Already enacted in seven states,[22] it is currently proposed in at least six more.[23] Some states confine the exemption to milk[24] or to sales of luncheons to school children.[25] Others have attempted to extend the exemption to a fairly large list of specific staples,[26] but the effect of this enumeration is to enlarge problems of administration and to encourage petty litigation over definitions. Thus, in Alabama it was necessary to go to court to determine that flour included self-rising flour;[27] in Arkansas, to determine that butterfats included whole milk.[28] Most states, therefore, exclude all food products purchased for human consumption, frequently excepting from that definition candies and confectionaries, vitamin medicines, soft drinks and sodas, and food prepared and served on the premises.[29] These exceptions of luxurious food purchases also give rise to administrative difficulty, especially in distinguishing between confectionaries and ordinary sugar products. A Hershey bar has been found by the United States Supreme Court to be a candy, and not a food, for the purposes of a federal statute taxing candy;[30] but the Ohio supreme court has found a chocolate peppermint to be a food, and not a candy or confectionary excepted from the food exemption.[31] Further opportunity for judicial extension or contraction of the scope of the exemption is afforded in the construction of the phrase "for human consumption." The court in *Kirk v. Johnson*[32] narrowly construed that phrase to mean immediate human consumption, rendering taxable the sale of a dairy cow for milking and ultimate slaughtering and consumption.

A food exemption drastically reduces sales tax receipts. If the North Carolina experience in the fiscal year 1939-1940 be typical, the tax receipts from sales by gro-

[22] Ala. Gen. Acts 1939, acts No. 18, §5(o), and 155; CAL. GEN. LAWS (Deering, Supp. 1939) act 8493, §2(e), §5(e); La. Laws 1940, act 115, §4; MICH. COMP. LAWS (Mason, Supp. 1940) §3663-4a(d); N. C. Pub. Laws 1941, c. 158, §6(c); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2) and (11-a); Okla. Laws 1939, c. 66, §6(i).

[23] Ark. H. B. No. 426; Ind. H. B. No. 418; Ore. H. B. No. 304; Wash. H. B. No. 167, S. B. No. 23; W. Va. H. B. No. 22, S. B. No. 89, all 1941. Wis. S. J. Res. No. 9, 1941, proposes a constitutional amendment to exempt food, clothing, fuel, or "other necessary of life."

[24] Ala. Gen. Acts 1939, act No. 155; La. Laws 1940, act 115, §4.

[25] Ala. Gen. Acts 1939, act No. 18, §5(o); CAL. GEN. LAWS (Deering, Supp. 1939) act 8493, §2(e); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-4a(d); OHIO GEN. CODE ANN. (Page, 1937) §5546-2 (11-a); Okla. Laws 1939, c. 66, §6(i). See also Ark. H. B. No. 426, 1941.

[26] Until recently North Carolina exempted flour, meal, meat, lard, milk, molasses, salt, sugar, coffee, bread, and rolls. N. C. Pub. Laws 1939, c. 158, §406(i). Until recently Washington exempted fresh sweet milk, raw fruit, butter, eggs, cheese, and bread. Wash. Laws 1935, c. 180, tit. 3, §19. W. Va. S. B. No. 89, 1941, would exempt sales of bread, milk, eggs, flour, and butter.

[27] Holt v. Long, 234 Ala. 369, 174 So. 759 (1937). At that time Alabama exempted sweet milk, buttermilk, cornmeal, flour, dry salt sides, salt fat backs, plates, bellies, sugar, and coffee. Ala. Loc. and Gen. Laws 1936-7, act No. 125, §4(j).

[28] Wiseman v. Affolter, 192 Ark. 509, 92 S. W. (2d) 388 (1936). At that time Arkansas exempted "all foods necessary to life," specifically defined as flour, meat, lard, sugar, soda, baking powder, salt, meal, butterfats, eggs, and medicines. Ark. Laws 1935, act 233, §15(2).

[29] CAL. GEN. LAWS (Deering, Supp. 1939) act 8493, §5(e); N. C. Pub. Laws 1941, c. 158, §6(c); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2). See, on this point, HAIG AND SHOUP, *op. cit. supra* note 12, at 653-654.

[30] McCaughn v. Hershey Co., 283 U. S. 488 (1931).

[31] Andrews v. Tax Comm., 135 Ohio St. 374, 21 N. E. (2d) 106 (1939).

[32] 37 Cal. A. (2d) 224, 99 P. (2d) 279 (1940).

cery, meat, fruit, and vegetable markets alone would exceed in amount the entire automotive, apparel, or furniture groups and would represent roughly ten per cent of the entire proceeds from sales and use taxation.[33] Under the North Carolina law as it then stood the exemptions of specific food items withdrew about two-fifths of all food sales from taxation. A few weeks after the inauguration of a new governor, who had campaigned on a blanket food exemption plank, such an exemption was legislatively approved, with an anticipated loss in revenue estimated at $1,500,000.

This effort to mitigate the regressive features of the tax, although justified because it surely "alleviates the living costs of the masses,"[34] is at the same time an effort to undo what the tax itself purports to do: measure consumer outlay. The very existence of these exemptions thus testifies to the unsoundness of such a policy. And their presence is little more than a patchwork remedy. The purchase of an article, in the first place, is often to be termed necessitous or luxurious depending not so much upon the nature of the article as upon the relationship of the purchase to the consumer's needs.[35] When a wealthy man purchases 50 pairs of shoes, food for a lavish banquet, and water for his lawn and gardens, the burden of taxation is eased upon him as well as upon his poorer neighbor, with a consequent loss of revenue which is a problem for both citizen-taxpayers. No state, in the second place, has attempted more than a sporadic exemption of this or that necessity; the alternative of working out a fairly consistent blanket of exemptions of necessitous articles would pose the problem of legislative demarcation of the limits of "necessities" and "luxuries" in a society with a fixed or changing standard of living.

Multiple Taxation

Multiple taxation, as it relates to consumption taxes, may result from placing several different taxes on the sale of the finished product (horizontal), or from taxing the commodity at various stages of its assimilation (vertical). In most instances the states have assiduously tried to avoid multiple taxation by express exemptions and by denominating certain transactions as wholesale, which are thus put outside the scope of the retail acts.

In general, exemptions of the horizontal type are economically justified, since they prevent discrimination against expenditures on commodities which are specially taxed, usually at a rate higher than that of the general consumption taxes. Included in this group are the exemptions of alcoholic beverages,[36] cigarettes and

[33] The fruit-vegetable-grocery-meat tax proceeds in North Carolina in the fiscal year 1939-40 were $1,711,392.60. By comparison the automotive group yielded $1,610,986.38; the apparel group, $990,679.89; and the furniture group, $810,945.97. The total yield was $11,377,980.37. N. C. Dept. Rev., *Analysis of Sales and Use Tax Collections for Fiscal Year July 1, 1939 through June 30, 1940* (mimeographed).

[34] BUEHLER, *op. cit. supra* note 11, at 153.

[35] Ohio H. B. No. 253, 1941, would exempt the first $25 of the purchase price paid for clothing or shoes.

[36] Ala. Gen. Acts 1939, act No. 18, §5(e); ARK. DIG. STAT. (Pope, 1937) §14082(b); COLO. STAT. ANN. (Michie, 1935) c. 144, §15 (where the special tax exceeds 12½% of sales price); IOWA CODE (Reichmann, 1939) §6943.077 ("blanket" provision); KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3606 (a); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(5); Okla. Laws 1937, c. 66, art. 11, §6(a); S. D. CODE (1939) §57.3202(6); Utah Laws 1933, c. 63, §6 ("blanket" provision).

other tobacco products,[37] malt,[38] amusements,[39] motor vehicles,[40] and other products and services which are specially taxed. Several states have blanket exemptions of sales otherwise taxable, either by the home state or by another state.[41] Since these exemptions operate *pro tanto,* the buyer is excused from paying the entire general sales or use tax only when it is less than the other consumption tax; if the latter tax is less, the buyer must pay the difference between the two. Arkansas does not confine the credit to cases in which the other tax is a consumption tax but permits a deduction for that "portion of all retail sales on articles and/or commodities on which a State privilege tax or license is already collected."[42] The most common exemption, that of gasoline and other motor fuel, which appears in the acts of 19 states,[43] bears closer scrutiny. Originally, all funds from gasoline taxes were intended to be used for construction and maintenance of highways and roads; to a great extent they are still used for such purposes. In the states which exempt sales of gasoline and other motor fuel from the general sales tax, approximately 90 per cent of the funds derived from the special gasoline tax is allocated to the use of the highway departments. In short, these taxpayers are really paying for a special service, the building and upkeep of the roads. On the other hand, the funds from the general consumption taxes are not used for the particular benefit of any one class of taxpayers. It is evident, then, that this large revenue-reducing exemption, instead of short-circuiting an unfair discrimination against gasoline expenditures, unwisely prevents this commodity from bearing its just portion of the general tax burden. At least, it should be subjected to the retail sales taxes to the extent that the gasoline is purchased for consumption.[44]

[37] Ala. Gen. Acts 1939, act No. 18, §5(1); ARK. DIG. STAT. (Pope, 1937) §14082(b) (blanket provision); COLO. STAT. ANN. (Michie, 1935) c. 144, §15 (where special tax exceeds 12¼% of sales price); IOWA CODE (Reichmann, 1939) §6943.077 (blanket provision); KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3606(a); MISS. CODE ANN. (Supp. 1938) §2326; OHIO GEN. CODE ANN. (Page, 1937) §5546-2(4); Okla. Laws 1937, c. 66, art. 11, §6(b); S. D. CODE (1939) §57.3202(6); Utah Laws 1933, c. 63, §6 (blanket provision).

[38] See statutes collected in note 36, *supra.*

[39] COLO. STAT. ANN. (Michie, 1935) c. 144, §15 (blanket provision); MISS. CODE ANN. (Supp. 1938) §2326.

[40] IOWA CODE (Reichmann, 1939) §6943.108; N. D. Laws 1939, c. 241, §3(2) (use tax exemption); Okla. Laws 1939, c. 66, art. 11, §6(n); S. D. Laws 1939, c. 276, §4(2) (use tax exemption); W. VA. CODE ANN. (Michie & Sublett, 1937) §999(9)5.

[41] IOWA CODE (Reichmann, 1939) §6943.077; KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3705 (use tax exemption); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-44(f) (use tax exemption).

[42] ARK. DIG. STAT. (Pope, 1937) §14082(b). Tax avoidance possibilities in such a provision appeared in Wiseman v. Madison Cadillac Co., 191 Ark. 1021, 88 S. W. (2d) 1007 (1935), when the buyer of an automobile tried to credit against the sales tax thereon, the fee which he had paid for permission to drive the car. But the court held that this was a tax on the privilege of using the roads, and, the tax not being on a commodity, that the claim for the exemption was ill-founded.

[43] Ala. Gen. Acts 1939, act No. 18, §5(c); ARIZ. CODE ANN. (1939) §73-1329; ARK. DIG. STAT. (Pope, 1937) §14082(b); CAL. GEN. LAWS (Deering, 1937) act 8493, §6; COLO. STAT. ANN. (Michie, 1935) c. 144, §15; IOWA CODE (Reichmann, 1939) §6943.077; KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3606(a); MISS. CODE ANN. (Supp. 1938) §2326; MO. REV. STAT. ANN. (1939) §11409; N. M. STAT. ANN. (Courtright, Supp. 1938) §141-1716(i); N. C. CODE ANN. (Michie, 1939) §7880(156)f(b); N. D. Laws 1937, c. 249, §4; OHIO GEN. CODE ANN. (Page, 1937) §5546-2(3); Okla. Laws 1939, c. 66, art. 11, §6(1); S. D. CODE (1939) §57.3202(6); Utah Laws 1933, c. 63, §6; WASH. REV. STAT. ANN. (Remington, Supp. 1940) §8370-19(e); W. VA. CODE ANN. (Michie & Sublett, 1937) §999(9)1; Wyo. Laws 1937, c. 102, §6.

[44] For a good discussion of this general problem, see JACOBY, *op. cit. supra* note 11, at 108 *et seq.;* and see Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes, supra* this issue.

Avoidance of multiple taxation of the vertical type is illustrated by the exclusion, adopted by practically every state, of sales to manufacturers and producers of tangible personal property which "enters into and becomes an ingredient or component part of tangible personal property to be ultimately sold at retail." As a sheer matter of legislative nomenclature, this is not an exemption but is a part of the definition of a wholesale sale, not reached by retail sales taxes; as a matter of economics, it is an exemption, for it saves the sale of ingredient commodities from the tax, while the sale of non-ingredient commodities, which also contribute to the cost that the consumer must pay for the finished product, is taxed.

The operation of this exemption can best be shown by a simple example: A manufacturer of cotton clothing buys cotton, an office desk, and a cutting machine.[45] In every state which has the physical ingredient rule, the sale of the cotton is exempt, since it becomes an integral part of the ultimate product. In every state except Michigan, Ohio and West Virginia, the sale of the machine would be taxed as a non-ingredient. And, with the exception of West Virginia, every state taxes the sale of the office desk for the same reason.[46]

There seems to be no sensible reason for this distinction, for obviously, the cost of the machine and desk enters into the price of the manufactured product as much as does the cost of the cotton.[47] If an aversion to pyramiding motivates the exemption of physical ingredients, then the sales of all articles whose costs enter into the cost of the ultimate goods, should be exempt.[48] Unwarranted though it is, the distinction is superficially hidden by the legislative declarations that the sale of an ingredient is a sale for resale, and hence not taxable, whereas the sale of a non-ingredient is a sale for consumption, since this commodity "shall never again enter trade channels as an article of merchandise." Whether or not a sale to a manufacturer or producer is in the economic sense a sale for consumption, it is clear that the use of the concept

[45] Essentially the same facts are presented in Bedford v. Colorado Fuel & Iron Corp., 102 Colo. 538, 81 P. (2d) 752 (1938), in which the court construed "enters into the processing of" as "becomes an ingredient."

[46] Michigan defines a retail sale as any sale for consumption other than for "consumption or use in industrial processing. . . ." MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b). Ohio's definition of retail sale is any sale other than a sale in which the purpose is to incorporate the article, or "to use or consume the thing transferred *directly* in the production of . . ." property to be sold at retail. OHIO GEN. CODE ANN. (Page, 1937) §5546-1. West Virginia defines a wholesale dealer as one who sells "machinery, supplies and materials . . . to persons engaged in manfacturing. . . ." W. VA. CODE ANN. (Michie & Sublett, 1937) §999(2)7.

[47] In State Board of Equalization v. Oil Wells Supply Co., 51 Wyo. 226, 65 P. (2d) 1093 (1937), and State Board of Equalization v. Stanolind Oil & Gas Co., 51 Wyo. 237, 65 P. (2d) 1095 (1937), the court granted the exemption to sales of commodities which were not ingredients, under a statute excepting sales of an article "which is actually used in the production of, . . . or becomes an ingredient." The legislature then amended the statute, so as to exempt only ingredients.

[48] This argument was successfully used in State Tax Comm. v. Burns, 236 Ala. 307, 182 So. 1 (1938). The court allowed the sale of food to a restaurateur, prepared for customers but eaten by employees, to go tax-free, on the ground that the cost of such food entered into the cost of employees' service, which in turn entered into the cost of the food upon which the customer paid a sales tax. The court said: "Those articles are constructively a part of that which is sold, and enhances its value on the basis of which the sales tax is paid." On rehearing, the court denied that its opinion conflicted with the physical ingredient rule, saying that the food had been purchased with intent to resell and not to consume. The physical ingredient rule in Alabama has since been repealed. *Cf.* Lone Star Cement Corp. v. State Tax Comm., 234 Ala. 465, 175 So. 399 (1937); Warren v. Fink, 146 Kan. 716, 72 P. (2d) 968 (1937).

of consumption to confine the exemption to sales of articles which become constituents of the finished product is economically indefensible in view of the purpose behind the physical ingredient rule. The mere fact of ingrediency is certainly unrelated to a desire to escape pyramiding.[49]

In most states many questions of construction of this exemption are obviated by the requirement that the article, for its sale to be exempt, must become a component part of the manufactured or produced commodity.[50] The Ohio provision, however, presents a difficulty of interpretation, since in addition to the sales of the commodities actually incorporated[51] it exempts also the sales of those articles "consumed or used directly" in the process of production. In those states where feed is deemed to become a component part of livestock,[52] there is the administrative difficulty of determining whether the livestock is to be sold, consumed personally by the producer, or both; for if it is consumed by the producer, the sale of the feed is taxable. And if the livestock is consumed in part and sold in part, administrators are presented with a difficult problem of allocation, one which is also raised by the physical ingredient rule and the exemption of sales of electricity, gas, and coal to be used in rendering taxable services.[53]

Political Considerations

Exemptions whose origins suggest the pressure of private interests reduce revenues without mitigating any unfair consequences of the taxes, while the reasons advanced for them range from the honest but invalid to the deliberately spurious.

The exemption of the purchase of mill machinery in five states,[54] for example, is predicated on the necessity for attracting new industries to the state and for keeping local industries from moving to neighboring states. But there is evidence, confirmed by the experience of the majority of the states which have not found the insertion of this exemption necessary, that taxation is not one of the eleven motives which

[49] The physical ingredient rule as a technique for defining retail sale is discussed at length by Wahrhaftig, *Meaning of Retail Sale and Storage, Use or Other Consumption, supra* this issue.

[50] A sale of fertilizer is not exempt, as entering into the processing of crops. Kennedy v. State Board, 224 Iowa 405, 276 N. W. 205 (1937). A sale of rubber heels to a shoe repairer is exempt. Revzan v. Nudleman, 370 Ill. 180, 18 N. E. (2d) 635 (1938). But see W. J. Sandberg Co. v. State Board, 225 Iowa 103, 278 N. W. 643 (1938), in which the court distinguishes between rubber heels and leather used in repairing shoes. A sale of parts of watches to a watch repairer is exempt. Marshall Co. v. Ames, 373 Ill. 381, 26 N. E. (2d) 483 (1940).

[51] Broadly, the Ohio test of direct use is whether the commodity is used in the production room or elsewhere. See JACOBY, *op. cit. supra* note 11, at 132, n. 38; 1 OP. OHIO ATT'Y GEN. (1935) 422, Op. No. 4149.

[52] In Union Stock Yards v. State Tax Comm., 93 Utah 166, 71 P. (2d) 538 (1937), the court refused to read in an exemption of the sale of feed, as being a component part of livestock.

[53] Administrators realize the near futility of trying to make such an allocation. The Kansas revenue office seeks to go no further than to determine whether the dominant intent of the buyer is to resell or to consume. Kan. Reg. and Rulings (1940) art. 9(d). Compare State Tax Comm. v. Burns, *supra* note 48. For a judicial treatment of the problem of allocation, see Smith Oil Co. v. Dep't of Finance, 371 Ill. 405, 21 N. E. (2d) 292 (1939).

[54] Ala. Gen. Acts 1939, act No. 18, §5(r), expressly exempts mill machinery. N. C. CODE ANN. (Michie, 1939) §7880(156)f(m), expressly exempts mill machinery as a wholesale sale. MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b), excludes from the definition of retail those articles which are "used in industrial processing." N. D. Laws 1939, c. 241, §3(8), and S. D. Laws 1939, c. 276, §4, exempt only from the use tax "products used in manufacturing."

induce industries to move.[55] Nor is the avoidance of multiple vertical taxation a satisfactory justification for this exemption, since no effort is made to relieve from taxation other non-ingredient purchases made by mills. The rather bold argument of the manufacturers in *Boyer-Campbell Co. v. Fry*[56] that the sale of mill machinery should be excluded from the definition of sale at retail mainly because the tax would cause "irreparable injury to business interests" in the state was fortunately unavailing, although the private interests later carried their contention successfully to the legislature.[57]

The very frequent exemption of the sale of newspapers[58] may be sustained because of the difficulty of taxing the consumer on three-cent or five-cent purchases and the unfairness of requiring the seller to bear the burden by remitting a designated percentage of gross receipts. But the exemptions of the sales of magazines[59] and religious publications,[60] newsprint,[61] and advertising[62] are not defensible. They are said to encourage the publication of information and the distribution of literature; but newspapers and magazines are not exempted from income, property, and other forms of state taxation which are now, significantly enough, past condemnation in the public press, while the sale of paper for books, less likely vehicles for the circulation of adverse comment on sales taxes and legislators, is not exempt from sales tax statutes.

The prevention of repeated taxation on the same article has been advanced as a reason for exempting the sale of used property, especially used automobiles.[63] A consumer tax, however, is a tax measured by consumer outlay, so that there is in this attempted justification the same confusion between physical and economic burden which is apparent in the exemption of the sale of ingredients entering into the physical substance of other articles later to be sold. Taxpayers, if there is no exemption, pay a tax again and again on the sale of the same used car as it is turned in and re-sold. But "there is no limit," as the court pointed out in *Bedford v. Hartman*,[64] in which it was contended unsuccessfully that the tax statute could not have

[55] See findings of Civic Development Committee of the National Electric Light Association and the Policy Holders' Service Bureau of the Metropolitan Life Insurance Company commented on in Martin, *supra* note 1, at 52.

[56] 271 Mich. 282, 260 N. W. 165, 98 A. L. R. 827 (1935).

[57] MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(b).

[58] Ala. Gen. Acts 1939, act No. 18, §5(j); Cal. Laws 1940, c. 46, §2.5 (all publications); N. M. STAT. ANN. (Courtwright, Supp. 1938) §141-1716(h); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2b); Okla. Laws 1939, c. 66, §6(j); WASH. REV. STAT. ANN. (Remington, Supp. 1940) §8370-19(c).

[59] N. M. STAT. ANN. (Courtwright, Supp. 1938) §141-1716(h); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2b) (subscriptions). Alabama exempted the sale of ". . . agricultural or religious publications and magazines," Ala. Gen. and Loc. Acts 1936-7, act No. 126, §4(1), until Long v. Paulos, 234 Ala. 149, 174 So. 230 (1937), interpreted the provision to include all magazines. The word "magazines" was dropped when, with changes, the statute was re-enacted. Ala. Gen. Acts 1939, act No. 18, §5(j).

[60] Ala. Gen. Acts 1939, act No. 18, §5(j).

[61] *Ibid.;* CAL. GEN. LAWS (Deering, Supp. 1939) act 8495a, §4(h) (use tax only); N. M. Laws 1939, c. 95, §4(j).

[62] Okla. Laws 1939, c. 66, §6(p) (also advertising on billboards); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(c).

[63] Ala. Gen. Acts 1939, act No. 18, §5(p); IOWA CODE (Reichmann, 1939) §6943.076(5); KAN. GEN. STAT. ANN. (Corrick, Supp. 1939) §79-3602(h); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(g); N. C. CODE ANN. (Michie, 1939) §7880(156)h; Colo. H. B. No. 355, 1941.

[64] 104 Colo. 190, 194, 89 P. (2d) 584, 585-586 (1939).

meant to tax the sale of a used car, "to the number of times a particular article of merchandise may be subject to a sales tax so long as it remains in the stream of commerce and goes through the regular channels of trade . . ." This form of repeated taxation, which is neither a multiple or pyramided taxation, is objectionable only to automobile dealers, for whom the disposal of second-hand automobiles is a major problem. Not only will the court not find a used-property exemption where none is expressed; in North Carolina at least, it has been unfriendly to one which existed. The exemption of "used articles taken as part payment on the sale of new articles" was held, in *McCanless Motor Co. v. Maxwell,*[65] not to exempt the sale of used articles taken in part payment for other used articles.[66]

The exemption of fertilizer,[67] agricultural containers,[68] and non-ingredient feeds and seeds,[69] all purchased chiefly by farmers, is an exemption found in many states. Although it results in certain mitigative consequences if the farmer-buyer happens to be poor, it is traceable more directly to the hand of agricultural blocs in state legislatures.

Outright subsidy, motivated either by a consideration of the importance of the industry to the economic well-being of the state, or by pressure brought to bear by that industry, or both, is the net effect of the exemption of ice in North Carolina and Ohio,[70] explosives in Ohio,[71] minerals in Utah,[72] cotton and cotton seed in Arkansas and Mississippi,[73] gold and silver in California,[74] agricultural limestone in Iowa,[75] railroad equipment in Alabama and New Mexico,[76] and vessels of more than a specified weight in Alabama, California, Michigan, and Ohio.[77]

A very large number of states exempt the sales by utilities of transportation services, and of electricity, steam, gas, fuel, and water when made to consumers through

[65] 210 N. C. 725, 188 S. E. 389 (1936).

[66] Ratchford, *The Measure of Consumption Taxes, supra* this issue, discusses the problem of trade-ins from the point of view of measurement of the tax base.

[67] Ala. Gen. Acts 1939, act No. 18, §5(g); IOWA CODE (Reichmann, 1939) §6943.074(3); MISS. CODE ANN. (Supp. 1938) §2328(m); N. M. Laws 1939, c. 95, §4(h) (use tax); Wyo. Laws 1937, c. 102, §2(f). Mississippi taxes manufacturers on the value of the goods manufactured as determined by gross proceeds of sale, whereas retailers are taxed directly on their gross proceeds. MISS. CODE ANN. (Supp. 1938) §§2319, 2320. The exemption of the sale of fertilizer and agricultural containers under this joint tax does not entitle manufacturers to deduct proceeds from fertilizer sales, Jackson Fertilizer Co. v. Stone, 173 Miss. 183, 162 So. 171 (1935), or from sales of agricultural containers. Southern Package Corp v. State, 174 Miss. 212, 164 So. 45 (1935).

[68] Ala. Gen. Acts 1939, act No. 18, §5(i); MISS. CODE ANN. (Supp. 1938) §2328(m); Wyo. Laws 1937, c. 102, §2(f).

[69] Ala. Gen. Acts 1939, act No. 18, §5(h); MISS. CODE ANN. (Supp. 1938) §2328(m); N. M. Laws 1939, c. 95, §4(h) (use tax); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2a); Wyo. Laws 1937, c. 102, §2(f).

[70] N. C. CODE ANN. (Michie, 1939) §7880(156)j; OHIO GEN. CODE ANN. (Page, 1937) §5546-2(2c).

[71] OHIO GEN. CODE ANN. (Page, 1937) §5546-2(11). [72] Utah Laws 1937, c. 114, §4(e).

[73] ARK. DIG. STAT. (Pope, 1937) §14071; MISS. CODE ANN. (Supp. 1938) §2328(i).

[74] CAL. GEN. LAWS (Deering, Supp. 1939) act 8493, §5(c), §5.14. Since most gold is sold to the United States, the sale of gold is almost completely exempt under the exemption in most states of sales to the Federal Government. Luke v. East Vulture Mining Co., 47 Ariz. 220, 54 P. (2d) 1002 (1936).

[75] IOWA CODE (Reichmann, 1939) §6943.074(3).

[76] Ala. Gen. Acts 1939, act No. 18, §5(n); N. M. Laws 1939, c. 95, §4(1).

[77] Ala. Gen. Acts 1939, act No. 18, §5(n); CAL. GEN. LAWS (Deering, 1937) act 8493, §5.7; MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(d); OHIO GEN. CODE ANN. (Page, 1937) §5546-2(13) (and dirigibles).

mains and pipes.[78] These exemptions, when not related to the avoidance of double taxation, the operation of the physical ingredient rule, or the exemption of necessaries, are probably attributable to the efforts of the public utilities in convincing legislators that gas, electricity, or bus rides are really not the sort of tangible personal property which should be included in the scope of the tax. But where there is no exemption there is certainly no reason for reading one in, either as to all utilities, as the court did in *Peoples Gas Light Co. v. Ames,*[79] or as to municipally-owned utilities, as the courts did in *Wyandotte v. State Board*[80] and *City of Webster Groves v. Smith.*[81]

One view of the policy of the use tax itself is to protect home industry by taxing purchasers on the use of commodities purchased outside the state, in order to discourage them from attempting to avoid the state sales tax. If the purchases, however, could not ordinarily have been made within the state, so that the out-state purchase was really no attempt to avoid the sales tax, there would be no reason for assessing a use tax; and this seems to have been the purpose behind the exemption in practically all states of commodities "not readily obtainable" or "not promptly purchaseable" in the state.[82] But if, under another view, the use tax is intended less to protect home industry from neighboring non-sales-tax states than it is to catch interstate sales not constitutionally taxable as sales, the not-readily-obtainable exemption has no relation to the purposes of the act. Inasmuch as the very enactment of the exemption would seem to imply that the legislature had adopted the former policy,[83] a case like *Continental Supply Co. v. People,*[84] in which the court declined

[78] Ala. Gen. Acts 1939, acts No. 18, §5(q), and 67, §3(q); CAL. GEN. LAWS (Deering, Supp. 1939) act 8493, §5(b); IOWA CODE (Reichmann, 1939) §6493.076(2); MICH. COMP. LAWS (Mason, Supp. 1940) §3663-1(e); N. M. STAT. ANN. (Courtwright, Supp. 1938) §141-1716(k); N. D. Laws 1937, c. 249, §3(b); OHIO GEN. STAT. ANN. (Page, 1937) §5546-2(b); Okla. Laws 1939, c. 66, §6(g), (h), and (m); S. D. CODE (1939) §57.3202(2) and S. D. Laws 1939, c. 276, §4(8); Utah Laws 2d Sp. Sess. 1933, c. 20, §4(b)1; W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §999(9)2. Wyo. Laws 1937, c. 118, §4(f) and (h), containing a similar exemption, has this year been amended to subject most public utility sales to taxation. Alone exempted are intracity cabs and buses charging less than 24 cents fare. Wyo. Laws 1941, c. 98.

[79] 359 Ill. 152, 194 N. E. 260 (1934). The court held that there was no retail sale of tangible personal property.

[80] 278 Mich. 47, 54, 270 N. W. 211, 213 (1936). The court said that "the well-established rule of exemption of municipal property from general taxation should carry over to the sales tax."

[81] 340 Mo. 798, 102 S. W. (2d) 618 (1937).

[82] MISS. CODE ANN. (Supp. 1938) §2358(d); S. D. Laws 1939, c. 276, §4(6) and (9); WYO. REV. STAT. (Supp. 1940) §115-2604(k); see JACOBY, *op. cit. supra* note 11, at 151-154. IOWA CODE (Reichmann, 1939) §6493.104(5) exempts property "not readily obtainable in Iowa and used in the operation of street railways." Here the readily-obtainable rule must have been adopted at the behest of private interests and modified so as to apply only to purchases made by them.

[83] In Pacific Tel. and Tel. v. Henneford, 195 Wash. 553, 560, 81 P. (2d) 786, 790 (1938), the court read in a readily-purchasable exemption and freed from taxation the purchase of telephone equipment outside the state. "The legislature," said the court, "by the title given to the statute declared that the tax was a compensating tax, which manifestly evinces neither purpose nor intention to tax non-competitor purchases which must be made outside this state." The following year, in City of Spokane v. State, 198 Wash. 682, 686, 89 P. (2d) 826, 828 (1939), the state came armed with the affidavits of legislators that the purpose of the act was to "compensate . . . for . . . loss of revenue resulting from the fact that the retail sales tax . . . could not be lawfully collected from Washington purchasers with respect to interstate sales." The affidavits were inadmissible, but the court overruled its earlier decision and refused to exempt waterworks property not purchasable in, and actually secured outside the state.

[84] 54 Wyo. 185, 88 P. (2d) 488 (1939).

to extend the exemption to the purchase of oil drills from out of the state, the seller's agent within the state not having had the drills in stock on demand,[85] constitutes an unwarranted judicial adoption of the contrary policy.[86]

The administrative difficulties arising out of confusion in policy and the possibility of argument in each fact situation over the meaning of "readily obtainable," have caused the Deputy Director of Taxation in South Dakota to remark that this exemption is "the worst trouble-maker that the writer has ever confronted in tax administration." The mere mention of patents, trade names, quality of goods desired, or quantity of goods ordered, serves to indicate some of the pitfalls in an attempted definition of what goods may be considered readily obtainable or promptly purchasable in a state.[87]

SELECTIVE SALES AND USE TAXES

The considerations which underlie exemptions from general sales and use taxes will already have been weighed in the pre-natal stages of the selective sales or use tax act. Delimitation of the taxable class to selected subjects, while it will not obviate exemptions that go to the type of consumer,[88] will necessarily remove in large part, if not entirely, the basis for commodity and transaction exclusions. Thus there are, within the scope of this study, no exemptions from the tobacco or beverage taxes. The same is essentially true of gasoline and motor fuel taxes, although there exists the borderline allowance of a refund or credit for satisfactorily proven loss of motor fuel by fire, lightning, explosion, accident, *etc.*[89] In other selective consumption taxes, however, are to be found exemptions predicated on commodity or transaction. A few states exempt from the prohibitive rates of their oleomargarine taxes the sales of oleomargarine when used in puff pastry shortening, salad and mayonnaise dressings, flavoring compounds, pharmaceutical preparations, and various oils and preservatives.[90] Kentucky's luxury taxes carry certain exemptions of functional character.[91] From the inclusive cosmetics tax, technically imposed upon receipt of these

[85] "It may be, as argued by counsel," said the court, "that under the construction given it, the subdivision will have little or a very restricted meaning. But that is what the legislature probably intended, in view of the fact, as already stated, that the use tax was meant to complement the sales tax." *Id.* at 193, 88 P. (2d) at 490.

[86] Compare the evaluation of this exemption by Wahrhaftig, *supra* note 49, who considers it in connection with the definition of use or other consumption.

[87] The exemption in Ohio of the sale of hearses to be used exclusively out of the state [OHIO GEN. STAT. ANN. (Page, 1937) §5546-2(12)] is an attempt to foster a home industry not by protecting it from other states but by encouraging out-state purchasers to come in and buy. This attempt to secure an advantage over the sellers of other states, whether the state of the buyer or another state to which the buyer would go instead of Ohio, invites a dangerous type of interstate competition. If the state of the buyer has a sales and use tax, moreover, the result of the exemption is to divert the tax on the hearse from the sales state granting the exemption to the state in which the use will be taxed, an example of subsidy at its worst. The move to repeal this exemption is well advised. Ohio S. B. No. 277, 1941.

[88] Exemptions of this character are covered by Conlon, *Express or Implied Exclusions from Consumption Excises—Types of Consumers, infra* this issue.

[89] *E.g.*, COLO. STAT. ANN. (Michie, 1935) c. 16, §383(a). This type of allowance is close to that for loss from shrinkage and evaporation, which is treated as a phase of measurement by Ratchford, *The Measure of Consumption Taxes, supra* note 66.

[90] ARK. DIG. STAT. (Pope, 1937) §13469; COLO. STAT. ANN. (Michie, 1935) c. 49, §19; IDAHO CODE ANN. (1932) §36-1001; UTAH REV. STAT. ANN. (1933) §66-0-1.

[91] KY. STAT. ANN. (Carroll, 1936) §4281d-1.

preparations in the state,[92] there are excluded soaps retailing at 30 cents a pound or less and prescriptions written by physicians and filled by registered pharmacists. Similarly, the tax on sales of candy and certain confections excludes cakes, cookies and breads that are filled, coated or iced with "confections similar to candy."

The most important commodity or transaction exemptions to be found among selective consumption taxes are those appearing in the taxes on admissions. Admission taxation, whether based on single transactions or on gross receipts and whether restricted to particular types of amusement activity or inclusive of all forms of entertainment, is catholic enough to precipitate problems of policy which often find ultimate solution in terms of exemption provisions. Exempt minima in a handful of states[93] testify to the existence here as with general consumption taxation of occasional concession to assumed administrative expediency. Apparently the Kentucky provision alone has precipitated litigation. *Martin v. F. H. Bee Shows*[94] involved the applicability of the state's general ten-cent exemption minimum to a carnival separately charging that amount for admission and for each concession within the grounds. The fact that the concessions were run by independents appears to have bottomed the holding that no tax was due. Recently, the same court was called upon to determine, on the basis of the rates established above this general free minimum, the tax applicable on charges for athletic contests above a 50-cent exemption minimum.[95]

Ohio's taxation of athletic contests where the price of admission is 41 cents or more and the proceeds inure wholly or in part to the benefit of any high school or academy[96] combines allowance of an exempt minimum with the far more common exemption of institutions and service groups. Where such exemption is granted,[97] the statutory provisions attest variations in the extent of the political pressures successfully exerted. Almost invariably, educational, religious and charitable institutions are specified; but also favored here and there are such groups as civic organizations, American legion posts, national guard and other military associations, agricultural fairs, police and fire departments[98]—and even Rooseveltian birthday balls.[99] Usually, it is enough if the activity for which admission is charged is that

[92] *Id.* §4281d-2, sustained as in effect a tax on sale and use after receipt, J. Bacon & Sons v. Martin, 305 U. S. 380 (1939).

[93] KY. STAT. ANN. (Carroll, 1936) §4281f-4 (athletic contests), *id.* §4281f-2, as amended Ky. Acts 1940, c. 181 (general); Mont. Laws 1937, c. 91, §5 (general); Tex. Laws 3d Sess. 1936, c. 495, p. 2069 (motion pictures and other like amusements); WASH. REV. STAT. (Remington, Supp. 1940) §8370-44 (general); W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §961 (general; subdivision of general "privilege" tax on certain businesses).

[94] 271 Ky. 822, 113 S. W. (2d) 448 (1938).

[95] Reeves v. Louisville Baseball Club, 283 Ky. 505, 142 S. W. (2d) 169 (1940).

[96] OHIO GEN. CODE ANN. (Page, 1937) §5544-3.

[97] No exemptions appear to be allowed in the admissions tax provisions of Ark. Acts 1935, art. 233; Me. Laws 1939, c. 282; MASS. ANN. LAWS (1933) c. 147, §40 (exemption only if boxing match is an incidental feature); MINN. STAT. (Mason, Supp. 1940) §3260-5(3); N. J. STAT. ANN. (1939) 5: 2-12; Utah Laws 1933, c. 63, §4(d); W. VA. CODE ANN. (Michie & Sublett, 1937) §2833 (8); WYO. REV. STAT. (Courtright, Supp. 1940) §115-2506 (exempts only sales *to* religious, charitable and eleemosynary institutions; section in general sales tax act).

[98] See, *e.g.*, the exemptions allowed by OHIO GEN. CODE (Page, 1937) §5544-3.

[99] S. C. Acts 1940, No. 1024.

of one of the groups specified,[100] or for its benefit.[101] Occasionally, however, there appear, alone or in combination, the further limitations that the activity itself must be of the specified character,[102] that no profit shall inure to any individual,[103] or that the proceeds must go largely or entirely to the purposes indicated.[104]

"There appear to be very few cases involving the question whether admission charges to athletic contests or other types of receipts from extracurricular activities of schools or colleges are subject to taxation."[105] The only recent decision seems to be *State Tax Comm. v. Board of Education,*[106] where the exceptionally strict Kansas exemption[107] was construed as not covering admissions to school dramatics, dances and athletic contests the proceeds from which were used to pay the costs involved. A forty-year-old North Carolina case, interpreting an "opera house tax" exemption of entertainments given for the sole benefit of religious, charitable or educational objects, held the tax inapplicable to conservatory concerts where any profit realized went toward new music and books.[108] Statutory exemptions of other favored groups have enjoyed similar freedom from litigation. Again Kansas appears to have provided the lone recent case. *State Tax Comm. v. State Board of Agriculture*[109] determined that the exemption of admissions to state and county fairs extended only to admission to the fair-grounds and was not intended to embrace admission to places of amusement and entertainment within the grounds. The probable explanation for the paucity of litigation over these exemptions lies in their similarity of wording to the much-litigated general property exemptions of like character.

[100] ARIZ. CODE ANN. (1939) §73-1303(f) (general); CONN. STAT. (1930) §2204 (boxing and wrestling); DEL. REV. CODE (1935) §5509 (racing); FLA. COMP. LAWS (perm. supp.) §4151(77) (same); ILL. STAT. ANN. (Jones, 1934) c. 5A, §13 (same), *id.* c. 8, §8 (boxing and wrestling); LA. GEN. STAT. ANN. (Dart. 1939) §8787.12 (authorization of municipal general admission taxes); MD. CODE (Flack, 1939) art. 56, §117 (boxing and wrestling); MICH. COMP. LAWS (Mason, Supp. 1940) §8859(10) (same); MO. REV. STAT. (1939) §14605 (same), *id.* §11453 (general); MONT. REV. CODE ANN. (Anderson & McFarland, 1935) §4554 (boxing), Mont. Laws 1937, c. 91, §8 (general); N. Y. UNCONSOL. LAWS §220 (boxing and wrestling), *id.* §1137 (racing); PA. STAT. ANN. (Purdon, Supp. 1940) tit. 4, §23 (boxing and wrestling); Tex. Laws 3d Sess. 1936, p. 2077 (general); VA. CODE ANN. (Michie & Sublett, 1936) §585(51)(u) (boxing and wrestling); W. VA. CODE ANN. (Michie & Sublett, 1939) §961 (general; subdivision of general "privilege" taxes on various classes of business); WIS. STAT. (1939) §169.01(20)(a) (boxing).

[101] CAL. GEN. LAWS (Deering, 1937) art. 6129, §7 (boxing; *cf.* §13, classifiable under note 100, *supra*); OHIO GEN. CODE (Page, 1937) §5544-3(1) (general).

[102] KAN. REV. STAT. (Corrick, Supp. 1939) §79-3603(e) (general; section in general sales tax act. See also note 104, *infra*).

[103] KY. STAT. ANN. (Carroll, Supp. 1940) §4281f-2 (general; see also note 104, *infra*); MISS. CODE ANN. (Supp. 1938) c. 75A, §534 (general); S. C. CODE (Michie, Supp. 1936) §2531 (same); WASH. REV. STAT. ANN. (Remington, Supp. 1940) §8370-49 (same).

[104] KAN. REV. STAT. (Corrick, Supp. 1939) §79-3603(e) (general; section in general sales tax act); KY. STAT. ANN. (Carroll, Supp. 1940) §4281f-2 (general); N. C. CODE (Michie, 1939) §7880 (37) (plays and shows; tax applies even so unless local talent used); OHIO GEN. CODE (Page, 1937) §5544-3(2) (fairs); WASH. REV. STAT. ANN. (Remington, Supp. 1940) §8276-16 (athletic contests; proceeds must go primarily for benefit of members of groups exempted).

[105] Anno. (1938) 115 A. L. R. 1411.

[106] 146 Kan. 722, 73 P. (2d) 49 (1937). Friedman v. State, 242 App. Div. 314, 275 N. Y. Supp. 64 (1934), *aff'd per curiam,* 268 N. Y. 529, 198 N. E. 388 (1935), concerned a very special situation of little or no general significance.

[107] See notes 102 and 104, *supra.*

[108] Markham v. Southern Conservatory, 130 N. C. 276, 41 S. E. 531 (1902).

[109] 146 Kan. 720, 72 P. (2d) 965 (1937).

EXPRESS OR IMPLIED EXCLUSIONS FROM CONSUMPTION EXCISES—TYPES OF CONSUMERS

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Exemptions from consumer excises,[1] based on the type of consumer purchasing or using the taxed goods or services, may conveniently be divided into two categories, those based on constitutional grounds and those granted by the legislature pursuant to some policy of its own. The former class involves chiefly those exemptions grounded in implied governmental immunities while the latter varies much from state to state with two exceptions, one the consequence of federal requirement and the other of a tax principle uniformly accepted in the states. State legislative freedom in classification has come about only by judicial declination of the contention that sales and use exactions have the constitutional status of property taxes. For under a number of state constitutions exemptions as well as rates in property taxation must be uniform among all classes of persons or property; if, therefore, consumer taxes were held to be subject to this requirement there would exist little leeway for a legislative exemption policy. However, sales taxes have in a number of cases been construed to be true excises[2] and the legislatures thus accorded wide

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[1] The term is used to denote general and selective sales and use taxes.

[2] *Motor fuel,* which as the earliest commodity subject to sales taxation, has naturally borne the brunt of legal attack: Bowman v. Continental Oil Co., 256 U. S. 642 (1921); State v. City of Montgomery, 228 Ala. 93, 151 So. 856 (1933); People v. City and County of Denver, 84 Colo. 576, 272 Pac. 629 (1928); Sheip and Co. v. Amos, 100 Fla. 863, 130 So. 699 (1930); Breese Lumber Co. v. Mirabal, 34 N. M. 643, 287 Pac. 699 (1930), *aff'd,* 283 U. S. 788 (1931); Stedman v. Winston-Salem, 204 N. C. 203, 167 S. E. 813 (1933); State v. Brown, 112 Ohio St. 590, 148 N. E. 95 (1925); Foster and Creighton Co. v. Graham, 154 Tenn. 412, 285 S. W. 570 (1926); State v. Hart, 125 Wash. 520, 217 Pac. 45 (1923). In Amos v. Mathews, 99 Fla. 1, 126 So. 308 (1930), it was held that the second and third gasoline taxes (really additions to the basic tax) were on the privilege of selling gasoline and not for the privilege of road use. The gasoline tax has also been upheld against the claim that as a road user tax it violates the "no toll" provisions of the Federal Post Roads Act and the Federal Highway Act. Cunningham v. Potts, 9 F. (2d) 469 (W. D. Wash. 1925); Anthony v. Kozer, 11 F. (2d) 641 (D. Ore. 1926), appeals dismissed on jurisdictional grounds, 273 U. S. 651 (1927). *Sales:* Frazier v. Tax Comm., 234 Ala. 353, 175 So. 402 (1937); Wiseman v. Phillips, 191 Ark. 63, 84 S. W. (2d) 91 (1935); Leonard v. Maxwell, 216 N. C. 89, 3 S. E. (2d) 316 (1939); Fox v. Frank, 52 Ohio App. 483, 198 N. E. 873 (1935); Assessment of Knapp, 185 Okla. 584, 95 P. (2d) 92 (1939); Sioux Falls Motor Co. v. Welch, 65 S. D. 68, 270 N. W. 852 (1936). The first Illinois sales tax was construed as a property tax and held unconstitutional because it exempted sales on farm products and

discretion in the matter of classifying users and uses of property subject to tax.[3] The compensating use tax, apparently much more vulnerable to the charge that it is a property tax, has also been sustained as an excise on one attribute of property, its use.[4] The exemptions that are the product of this legislative discretion are first considered.

GASOLINE USER EXEMPTIONS

Only under the motor fuel tax is an exemption or refund privilege granted to any considerable class of users. Twenty-three states and the District of Columbia relieve from tax all non-highway use of gasoline, either by exempting the sale in the first instance or by refunding the amount of tax.[5] Eight other states, while adhering in general to the road toll principle, do not relieve non-highway use of all tax. These eight are Idaho, Michigan, Oregon and Virginia, which impose a low-rate tax on aircraft gasoline, South Dakota where the regular rate is payable on aircraft gasoline, Maine and Mississippi where the refund granted is one cent less than the rate of tax, and North Carolina where refunds are limited to five cents per gallon except in the case of aircraft gasoline.[6] Seven states—Nebraska, New Jersey, North Dakota, Oklahoma, Tennessee, West Virginia and Wyoming—exempt or refund the

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gasoline. Winter v. Barrett, 352 Ill. 441, 186 N. E. 113 (1933). A second act, in form a tax on the privilege of selling tangible personal property at retail, was sustained. Reif v. Barrett, 355 Ill. 104, 188 N. E. 113 (1933). *Tobacco:* Mississippi State Tax Comm. v. Flora Drug Co., 167 Miss. 1, 148 So. 373 (1933); Havens v. Attorney General, 14 A. (2d) 636 (N. H. 1940); Stephano Bros. v. Hamilton, Ct. Com. Pleas. Dauphin County, Pa., 1940 (unreported).

Federal excises are indirect taxes and subject only to the requirement that they be geographically uniform. U. S. CONST. Art. I, §8, cl. 1; Hylton v. United States, 3 Dall. 171 (U. S. 1796); Nichol v. Ames, 173 U. S. 509 (1899); Knowlton v. Moore, 178 U. S. 41 (1900); Bromley v. McCaughn, 280 U. S. 124 (1929). Any doubt remaining after *Knowlton v. Moore* and *Brownley v. McCaughn*, that a federal general sales tax would be unconstitutional as a direct tax, should be dissipated by the view the Court has taken of state use taxes. See note 4, *infra*.

[3] Frazier v. Tax Comm., *supra* note 2; Montgomery Ward & Co. v. Fry, 277 Mich. 260, 269 N. W. 166 (1936); Southern Package Corp. v. Tax Comm., 174 Miss. 212, 164 So. 45 (1935); Notgrass Drug Co. v. State *ex rel.* Rice, 175 Miss. 358, 165 So. 884 (1936); Assessment of Knapp, *supra* note 2. See also Washington v. Inland Empire Refineries, 3 Wash. (2d) 651, 101 P. (2d) 975, *cert. denied*, 311 U. S. 713 (1940); and compare Morrow v. Henneford, 182 Wash. 625, 47 P. (2d) 1016 (1935).

[4] Henneford v. Silas Mason Co., 300 U. S. 577 (1937); Vancouver Oil Co. v. Henneford, 183 Wash. 317, 49 P. (2d) 14 (1935); City of Spokane v. Washington, 198 Wash. 682, 89 P. (2d) 826 (1939).

[5] ARIZ. CODE ANN. (1940) §66-319; CAL. GEN. LAWS (Deering, Supp. 1939) act 2964, §11; COLO. STAT. ANN. (Michie, 1935) c. 16, §384(c); CONN. GEN. STAT. (Supp. 1935) §656c; DEL. REV. CODE (1935) §222(b); ILL. STAT. ANN. (Jones, 1935) §85.124; IND. STAT. ANN. (Baldwin, 1934) §16033(a); IOWA CODE (Reichmann, 1939) §5093.29; KAN. REV. STAT. (Corrick, Supp. 1939) §79-3010; MD. ANN. CODE (Flack, 1939) art. 56, §255; MASS. ANN. LAWS (1933) c. 64A, §7; MINN. STAT. (Mason, Supp. 1940) §2720-71; MO. REV. STAT. ANN. (1929) §7805; MONT. REV. CODE ANN. (1935) §2396.4; NEV. COMP. LAWS (Hillyer, Supp. 1938) §6570.05; N. H. LAWS (1926) c. 104, §7, as amended by N. H. Laws 1935, H. B. No. 88; N. M. STAT. ANN. (Courtwright, Supp. 1938) §60-301; N. Y. TAX LAWS §289-c; OHIO GEN. CODE ANN. (Page, 1937) §5527(a); R. I. GEN. LAWS ANN. (1938) c. 45, §5; TEX. STAT. (Vernon, 1936) art. 7065a-13; W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §995(20); WIS. STAT. (1939) §78.02(2).

[6] Idaho Laws 1937, c. 57; Me. Laws 1937, c. 175, §80; MICH. COMP. LAWS (Mason, Supp. 1940) §3603-2; MISS. CODE ANN. (Supp. 1938) §1222(b); N. C. CODE ANN. (Michie, 1939) §2613(115); ORE. COMP. LAWS ANN. (1940) §101-1711 (differential tax on aircraft); S. D. CODE (1939) §57-3812; Va. Laws 1938, c. 368, as amended by Va. Laws 1940, c. 7.

tax on gasoline used for specified purposes.[7] In three of these states, New Jersey, North Dakota and West Virginia, refundable uses are comprehensive, embracing practically all non-highway uses. All gasoline is taxable in Arkansas and Florida with the exception of that used for aircraft, and, in Utah, all save that manufactured, used or sold within the state from local coal, oil shales, asphalts and solid hydrocarbons.[8] Alabama, Georgia, Kentucky, Louisiana, Pennsylvania, South Carolina and Vermont tax all gasoline except that which they are prohibited from taxing under constitutional limitations.[9]

Types and Amounts of Non-Highway Uses

The principal uses of tax-free motor fuel vary from state to state. In agricultural regions the operation of farm machinery such as tractors and stationary engines accounts for the greater part. In other sections of the country industrial uses predominate. Solvents classifiable as motor fuel are used in cleaning and dyeing work. Other non-highway uses include contracting and construction, governmental, railroad, marine and power generation.[10]

According to the latest information available about 92 per cent of all motor fuel consumed in 1939 was used on the highways. About nine per cent of the total amount of gasoline consumed was not taxed. The discrepancy between these two figures is caused in part by governmental use. About three per cent of all motor fuel was used by the federal, state and local governments and over 80 per cent of this amount was used on the highways.[11] Much of the gasoline used by local governments on the highways is taxed, for a number of the states do not exempt their political subdivisions.[12]

Limitations on Refunds and Exemptions

Even in those states where general non-highway use of gasoline is exempt from tax or a refund may be secured, the privilege does not apply to all gasoline so used. Motor fuel delivered into a vehicle tank and subsequently used for propelling the vehicle both on the public highways and on private property is not eligible for refund.[13] The usual requirement is that the motor fuel intended for non-highway

[7] Neb. Laws 1941, B. 470; N. J. STAT. ANN. (perm. ed.) tit. 54, §§39-65, 39-66; N. D. Laws 1937, c. 248, §2; Okla. Laws 1939, c. 66, art. 14, §§7-8; TENN. CODE ANN. (Williams, Supp. 1938) §1128.1; W. VA. CODE ANN. (Michie & Sublett, Supp. 1939) §995(20); Wyo. Laws 1941, c. 48, §4, amending WYO. REV. STAT. (Supp. 1940) c. 115, art. 11.

[8] ARK. DIG. STAT. (Pope, 1937) §66046; FLA. COMP. GEN. LAWS (Skillman, Supp. 1940) §1167(102); UTAH REV. STAT. ANN. (1933) §57-12-5.

[9] Ala. Acts 1935, H. B. No. 324, art. xiii, c. 4, sch. 156.1; Ga. Laws 1937, No. 191; KY. STAT. ANN. (Carroll, 1936) §§4281g-1, 4281h-1 (cleaner solvent exempt); LA. GEN. STAT. ANN. (Dart, 1939) §§8806, 8826 (cleaner solvent exempt by judicial construction); PA. STAT. ANN. (Purdon, Supp. 1940) §§2611b, 2611d; S. C. CODE (1932) c. 107, art. 3; VT. PUB. LAWS (1933) c. 52.

[10] Fed. Tax Adm'rs, *Administration of Gasoline Tax Refunds and Exemptions* (1940), and *Exempt and Refundable Uses of Gasoline* (1940); CRAWFORD, MOTOR FUEL TAXATION IN THE UNITED STATES (1939) c. 5.

[11] Federal Works Agency, Public Roads Administration, *Analysis of Motor Fuel Usage* (1939) Table G-21, and *Motor Fuel Consumption* (1939) Table G-2.

[12] State treatment of gasoline used by local subdivisions is discussed *infra*.

[13] Brady v. Long, 285 Mass. 379, 189 N. E. 83 (1934).

use be separately bought and invoiced. In Washington no refund is allowed for motor fuel used in vehicles that are capable of being operated on the public highways.[14] However, if the motor vehicle in which the fuel is used is of such a type that it is not eligible to be licensed for operation on the highways, a refund of tax may be obtained.[15]

The reason for these limitations lies in the difficulty of ascertaining the amount of motor fuel used for non-highway purposes. Because the administrator of the tax has no way of checking the accuracy of the user's estimates of highway and non-highway use, an unlimited refunding system would be open to many abuses. If complete operation records were regularly kept so that an accurate segregation of highway and non-highway use was possible a different result might follow.

An extremely liberal construction in favor of agricultural users of motor fuels has been made by the Oklahoma supreme court.[16] There the statute provides that a permit may be secured to purchase gasoline tax free for agricultural purposes. The application for a permit must show the legal description of the agricultural land owned, leased or rented. On the basis of this provision, the Tax Commission ruled that a permit holder could not buy tax-exempt motor fuel for use in work he was doing on land farmed by another. The commission regarded such a use as commercial rather than agricultural. The court, however, held that such a use was permissible, saying that the statutory test of exemption was whether the gasoline was used for agricultural purposes.

Basis for Non-Highway Use Exemption

The tendency to exempt non-highway uses from motor fuel taxation is quite understandable in view of the common acceptance of this type of tax as one paid on the basis of benefits received for road use. It has been contended, particularly in recent years, that a tax founded on the theory of direct benefit is of doubtful desirability. Not only may social considerations call for the extension of benefits to taxpayer groups relatively unable to pay for them; it is pointed out as well that it is quite difficult in most instances to evaluate the benefits received by various classes of taxpayers. This difficulty, however, is not so marked in connection with the gasoline tax as it is with respect to other types of benefit taxation. There is rather common agreement that at least a tolerable correlation of benefit and payment is possible in the case of the former. The consumption of gasoline and, therefore, the amount of tax paid varies approximately with the size and weight of the vehicle and the speed with which it is operated. Highway wear and tear also varies with the size, weight and speed of the vehicle. On the other hand, it has been pointed out that the correlation between consumption of gasoline and wear and tear on the roads is low for vehicles of different weights and it should also be noted that while the correlation between benefits and payments may be high for all motor-

[14] Elliott & Co. v. State, 191 Wash. 385, 71 P. (2d) 168 (1937).
[15] Mason-Walsh-Atkinson-Kier Co. v. Case, 2 Wash. (2d) 33, 97 P. (2d) 165 (1939).
[16] Protest of Hyde, 110 P. (2d) 292 (Okla. 1941).

ists as a group, there may be great discrepancies among individual motorists in the matter of taxes paid and benefits received. Such discrepancies depend on a number of factors, among them the manner in which the vehicle is used and the locality in which it is operated, whether on rural roads, state trunk highways, or city streets.[17]

But despite these and other technical difficulties involved,[18] it is an undeniable fact that the gasoline tax is commonly accepted as a road user charge. Indeed, two high-yield exactions, the social security and gasoline taxes, are predicated upon the benefit principle. Together, unemployment compensation and gasoline taxes accounted for over 40 per cent of all state tax collections in 1940.[19] More than exemptions for non-highway use flow from the theory and accepted basis of gasoline taxation; there is, correspondingly, much pressure to apply the total proceeds of this tax to highway purposes. Prior to 1931 over 99 per cent of state gasoline tax collections were devoted to highway construction and maintenance and the servicing of highway debt. But with the coming of the depression state legislatures turned to the gasoline tax to raise money for other than highway purposes. In 1932 non-highway functions received about nine per cent of total gasoline tax revenues; in 1939 the percentage was sixteen and one-half.[20] Diversion of such a significant percentage of these revenues has resulted in a movement to restrict the expenditure of motor fuel tax collections to the highways. The nature and effect of this movement, including the devices employed to achieve the end desired, are reviewed in an earlier portion of this symposium.[21]

OTHER LEGISLATIVE CONSUMER EXEMPTIONS

No class of individuals as consumers, comparable to non-highway users of gasoline, are legislatively exempted from other state sales or use taxes, including those on tobacco and liquor.[22] Under the general sales tax, sales to the state and its political subdivisions and to charitable and non-profit institutions are the more common instances where entities as such are exempt from tax. The nearest approach

[17] See GROVES, FINANCING GOVERNMENT (1939) 354; SHULTZ, AMERICAN PUBLIC FINANCE (2d rev. ed. 1938) 540-541; BUEHLER, PUBLIC FINANCE (2d. ed. 1940) 646-652.

[18] If the benefit theory is to be strictly applied to gasoline and motor vehicle taxation, further questions are presented. On what basis should costs and benefits be allocated among different users? What governmental units should maintain which streets? Should road users pay all highway costs? What proportion of real property or other local taxes should be devoted to city streets? For studies dealing with these problems, see PUBLIC AIDS TO TRANSPORTATION (1940), a report of the Federal Coordinator of Transportation; MOULTON, THE AMERICAN TRANSPORTATION PROBLEM (1933); BREED, HIGHWAY COSTS (1939), a report to the Association of American Railroads; STOCKER, IS MOTOR TRANSPORTATION SUBSIDIZED; REPORT OF THE ROYAL COMMISSION ON TRANSPORTATION (Ontario, 1938).

[19] U. S. BUREAU OF THE CENSUS, STATE TAX COLLECTIONS (1940) Sp. Study No. 10.

[20] Federal Works Agency, Public Roads Administration, *Disposition of Motor Fuel Tax Receipts* (1938-1939) Table G-3; CRAWFORD, *op. cit. supra* note 10, c. 7. The Public Roads Administration publishes yearly, on the basis of information from official state agencies, a number of thorough analyses of data on motor fuel tax and motor vehicle license fee collections and expenditures.

[21] See Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes, supra* this issue.

[22] Various digests which include exemption provisions are available. See Am. Retail Fed., *State Sales Tax Laws* (1940); C. C. H., *Interstate Sales Taxes* (1940); Fed. Tax Adm'rs, *Digest of State Sales Tax Laws* (1940); TAX SYSTEMS OF THE WORLD (8th ed. 1940).

to an exemption of a class of individual consumers is found in those states which exclude sales of feed, seeds, and fertilizer. Although in statutory terms this is an exemption by type of commodity,[23] rather than by type of consumer, in essence it is of the latter type inasmuch as these articles constitute a goodly proportion of a farmer's purchases. One available ruling on the purpose of the exemptions on goods sold to farmers indicates a policy of fostering the business of farming. Sales of goods to farmers or dairymen are exempt if the articles sold are for the production of crops intended for marketing, but taxable if the purpose of the production is ultimate consumption by the grower himself.[24]

No matter what type of general sales tax is in force in a particular state, whether a tax on the privilege of buying or selling, or an excise on the sale itself, the practical effect of the tax does not vary from state to state. The administrator looks to the retailer as the responsible taxpayer, and the retailer adds the tax to the consumer's bill.[25] Since the consumer foots the bill some of the many and varied exemptions by type of commodity which are found in state sales tax statutes may be in reality limited exemptions to a particular type of consumer.

Although in Missouri a division of the state government has been held liable for state sales taxes on materials it purchases,[26] it is almost universal practice specifically to exempt from tax sales to a state's own departments.[27] Also undictated by constitutional necessity are the provisions quite commonly found exempting municipalities from payment of general and selective sales taxes on purchases of material, except gasoline, to be used for public purposes. These express provisions have seemingly given rise to no serious questions of construction. This is not true, however, of municipal and county efforts to spell such exemptions out of constitutional or statutory exemptions of local governments from all *ad valorem* taxes. These efforts have nevertheless generally met with failure before the state courts,[28] even the but-

[23] Frampton and Smith, *Commodities and Transactions Exempt from Consumption Taxes, supra* this issue, treat exemptions of such character.

[24] Farm Bureau Services, Inc. v. Board of Tax Admn., Circ. Ct. Ingham County, Mich., 1934 (unreported).

[25] The distinction between the statutory incidence and the economic incidence of various sales taxes has caused the courts some trouble. Compare, *e.g.*, McGoldrick v. Berwind-White Coal Mining Co., 308 U. S. 546 (1940), and Colorado National Bank v. Bedford, 310 U. S. 41 (1940), with *In re* Conklin, 110 F. (2d) 178 (C. C. A. 2d, 1940), and *In re* Newland, 115 F. (2d) 165 (C. C. A. 3d, 1940). See also Arkansas Power and Light Co. v. Roth, 103 Ark. 1015, 104 S. W. (2d) 207 (1937); Tanner v. State, 238 Ala. 265, 190 So. 292 (1939); Rush v. Brown, 187 Okla. 97, 101 P. (2d) 262 (1940). Consult further, Martin, *Distribution of the Consumption Tax Load, supra* this issue.

[26] State *ex rel.* Missouri Portland Cement Co. v. Smith, 338 Mo. 409, 90 S. W. (2d) 405 (1936).

[27] See the digests cited in note 22, *supra.*

[28] Birmingham v. State *ex rel.* Carmichael, 233 Ala. 138, 170 So. 64 (1936); Long v. Roberts and Son, 234 Ala. 570, 176 So. 213 (1937); State *ex rel.* Carmichael v. Board of Education, 237 Ala. 434, 187 So. 414 (1939); County Board of Education v. Alabama, 239 Ala. 276, 194 So. 881 (1940) (liable for penalties and interest also); McCarroll v. Mitchell, 198 Ark. 435, 129 S. W. (2d) 611 (1939); People v. City and County of Denver, 90 Colo. 598, 10 P. (2d) 1106 (1932); Wright v. Fulton County, 169 Ga. 354, 150 S. E. 262 (1929); Independent School District v. Pfost, 51 Idaho 240, 4 P. (2d) 893 (1931); People v. Deep Rock Oil Co., 343 Ill. 388, 175 N. E. 572 (1931); State v. Des Moines, 221 Iowa 642, 266 N. W. 41 (1936); City of Lawrence v. French, 31 Kan. 447, 18 P. (2d) 570 (1933); Covington v. State Tax Comm., 257 Ky. 84, 77 S. W. (2d) 386 (1934); State v. City of Monroe, 177 La. 983, 149 So. 541 (1933); Ardmore v. Oklahoma, 168 Okla. 316, 32 P. (2d) 728 (1934);

tress of home rule proving insufficient to give a municipality any preferred status so far as state excises are concerned.[29] Municipal resort to tax avoidance through the device of out-of-state purchase of gasoline has been successfully countered by state recourse to use taxation.[30] It is not uncommon to find the proceeds of a state's consumption excises shared with its political subdivisions. The practice is increasing and while there is no good reason for requiring those subdivisions to pay taxes on their purchases, they do in a number of cases receive this money back, although its use is frequently limited to specified objects.[31]

In connection with the other chief class of general consumer exemptions, sales to charitable and non-profit institutions, there is some diversity of opinion. If the consumer claiming the exemption is not a charitable and non-profit organization, the exemption has been held not to apply even though the profits of the organization are used to maintain an asylum which is purely a charitable institution.[32] The opposite view is not, however, without support.[33] Still another view holds that a charitable institution is liable for use taxes if it competes with a private business and derives income in excess of its expenses, without regard for the use to which this excess is put.[34]

DIPLOMATIC AND CONSULAR IMMUNITY

The second broad category of exemptions from excise taxes consists, it will be recalled, of those which derive from constitutional sources. So far as the states are concerned, exemption of diplomats by international usage and of consular officials by treaty action,[35] is of this character. Viewed from the federal standpoint, on the other hand, it is in each instance clearly the product of legislative and executive judgment rested upon the supremacy clause. This exemption thus partakes of both legislative and constitutional basis. While the federal government undoubtedly has the power to require the states and their subdivisions to respect exemptions granted

Portland v. Kozer, 108 Ore. 375, 217 Pac. 833 (1923); Greenville v. Query, 166 S. C. 281, 164 S. E. 844 (1931), *aff'd*, 286 U. S. 472 (1932); Crockett v. Salt Lake County, 72 Utah 337, 270 Pac. 142 (1928). *Contra:* Commonwealth v. Pure Oil Co., 303 Pa. 112, 154 Atl. 307 (1931), but now changed by statute. See also O'Berry v. Mecklenburg County, 198 N. C. 357, 151 S. E. 880 (1930).

[29] Lubbock v. Magnolia Petroleum Co., 291 S. W. 660 (Tex. Civ. App. 1927).

[30] Greenville v. Query, *supra* note 28; Texas v. El Paso, 135 Tex. 359, 143 S. W. (2d) 366 (1940). In further implementation of the power to tax local subdivisions it has been held that a state may levy on a city's property in order to force payment of tax. Greenville v. Query, 172 S. C. 133, 173 S. E. 292 (1934).

[31] Smart and Hart, *supra* note 21, discuss allocation of state-collected consumption taxes to local subdivisions.

[32] German Masonic Temple Ass'n v. City, 279 N. Y. 452, 18 N. E. (2d) 657 (1939), *rev'g* 253 App. Div. 680, 3 N. Y. S. (2d) 596 (1938).

[33] Bedford v. Colorado Fuel and Iron Corp., 102 Colo. 538, 81 P. (2d) 752 (1938). See also Sailors' Snug Harbor v. McGoldrick, 255 App. Div. 64, 5 N. Y. S. (2d) 322 (1938), *aff'd*, 280 N. Y. 537, 20 N. E. (2d) 7 (1939).

[34] Oklahoma Tax Comm. v. Sisters of the Sorrowful Mother, 186 Okla. 339, 97 P. (2d) 888 (1939).

[35] Unlike diplomats, consular officials do not *per se* by reason of international usage enjoy exemption from taxation by the nation to which they are accredited. By a number of treaties, however, the United States has exempted these officials from all taxes, national, state and municipal, which are levied on their persons and, with some exceptions, on their property.

by treaty,[36] a number of questions have arisen as to the meaning and breadth of the exception. The application of general sales and selective gasoline taxes has given the most trouble, with a consequent lack of uniformity in the state administrative rulings on the point. For example, Illinois, Louisiana, New York and North Carolina allow the exemption in the case of the gasoline tax. New York requires the payment of the motor vehicle license fee; Maryland does not. Colorado and Washington exempt from the payment of sales tax, while California does not. In general, if a line is to be drawn, perhaps the statutory incidence of the tax furnishes the most certain one.[37]

USES BY INSTRUMENTALITIES OF INTERSTATE COMMERCE

The much-litigated commerce clause bears witness that the beneficiaries of those exclusions which derive purely from constitutional sources may be private individuals or groups as well as governmental agencies or departments. Within the ambit of consumption excises, the use tax is the case in point. Although this tax has become more widely known through its adoption to implement the general sales taxes by equalizing the condition of competition between local merchants and out-of-state sellers, thus lessening avoidance of tax through out-of-state purchases by consumers, it had already been utilized for similar purposes under gasoline taxation. Either by express enactment of a use tax or by including the first user of gasoline in the statutory definition of a "distributor" or "dealer," most of the states had by 1931 an effectual selective use tax in operation.

The tax cannot be applied solely to the use of gasoline in an instrumentality of interstate commerce operating within a state, it was held in *Helson v. Kentucky*.[38] The gasoline sought to be taxed was purchased in Illinois and used in a ferryboat plying between Illinois and Kentucky, but spending the greater part of its time in Kentucky waters. The imposition by Kentucky of a tax on the gasoline thus used was held bad as a prohibited burden on instrumentalities engaged in interstate commerce. Confined to the precise facts the same result would probably be reached today, but in view of the later decisions there is no doubt that Illinois could tax the sale and delivery of the gasoline in the first instance.

A somewhat similar result was reached in *Bingaman v. Golden Eagle Western Lines*,[39] where an attempt was made to tax gasoline carried into the state in the tanks of buses operating exclusively in interstate commerce. This tax had been construed by the state courts as an excise on the use of gasoline, unconnected with the privilege of using the roads. The Supreme Court held the imposition invalid as a burden prohibited by the commerce clause. If the tax had been tied to the use of the roads, and imposed on some basis which apportioned the amount of

[36] In support of federal power in this respect are Fairfax v. Hunter's Lessee, 7 Cr. 603 (U. S. 1813); Missouri v. Holland, 252 U. S. 416 (1920); Neilson v. Johnson, 279 U. S. 49 (1929); Todok v. Union State Bank, 281 U. S. 281 (1930); Santovincenzo, Consul v. Egan, 284 U. S. 30 (1931).

[37] See Conlon, *Diplomatic and Consular Immunity from Taxation* (Fed. Tax Adm'rs Research Rep. No. 9, 1940), for a discussion of exemptions accorded to these types of consumers.

[38] 279 U. S. 245 (1929).

[39] 297 U. S. 626 (1935).

taxable gallonage to the approximate mileage traveled, there is little doubt that it would have been sustained. It was clearly indicated in *McCarroll v. Dixie Greyhound Lines*[40] that this procedure would be permissible inasmuch as the state is quite within its powers in insisting that interstate instrumentalities using the highways pay road user taxes, just as intrastate traffic does.

In the *Greyhound* case, however, the imposition of the tax was held to be a prohibited burden on interstate commerce for the reason that the base of the tax bore no relation to traveled mileage. The statute provided that 20 gallons of gasoline might be carried into the state in the vehicle tank, tax free.[41] The use tax applied on all gasoline over this exempted gallonage. Since the gasoline in the tank in excess of 20 gallons, the base of the tax, bore no relationship to the distance the bus would travel in the state, the statute fell. It further appears from this case that the tax act or its actual administration must be such that some sort of formal apportionment is made in terms of taxed gallonage to traveled mileage, for it was shown that, as a matter of fact, in the instance in suit the gallonage on which the tax was assessed corresponded roughly to the mileage traveled in the state. The relationship was accidental, however, resulting wholly from the amount of gasoline over 20 gallons the buses happened to be carrying on that occasion.

If the gasoline is sold and delivered within the state, or withdrawn from storage for delivery within the state, it does not matter that it is subsequently used in instrumentalities operated in interstate commerce, even in airplanes or trains, which do not use the public highways.[42] Some state court decisions formerly held that since the tax is for the use of the roads, it could not be applied to gasoline actually used outside the state.[43] However, where the gasoline is sold and delivered, or withdrawn from storage within the state, there is no longer any need to draw this distinction based on the purpose of the tax, or more properly speaking, on the disposition of the receipts from the tax.[44]

Nor is distinction taken between gasoline and articles of general commerce so far as use in instrumentalities of interstate commerce is concerned. The use tax, supplementing the general sales tax, is applicable to those articles destined for use in instrumentalities of interstate commerce if there is even a taxable "instant" between the time their transportation in interstate commerce ceases and their installation in an instrumentality of interstate commerce takes place.[45]

[40] 309 U. S. 696 (1940).

[41] A number of states have similar limitations. See Fed. Tax Adm'rs, *Statutory Provisions Exempting Fuel in Tanks of Motor Vehicles* (1940).

[42] Eastern Air Transport Co. v. South Carolina Tax Comm., 285 U. S. 147 (1932); Nashville, Chattanooga & St. Louis Ry. v. Wallace, 288 U. S. 249 (1933); Edelman v. Boeing Air Transport, 289 U. S. 249 (1933).

[43] Louisiana v. Johnson, 173 La. 669, 138 So. 503 (1931) (on the road tax theory, gasoline used outside the state is not taxable), overruled by State v. Tri-State Transit Co., 179 La. 811, 155 So. 233 (1934) (holding that the tax is an excise on all gasoline sold or consumed within the state). The intervening United States Supreme Court decisions, cited *supra* note 42, influenced the Louisiana court.

[44] Delaware v. Crane Hook Oil Storage Co., 18 A. (2d) 427 (Del. 1941) (there stipulated that only 15% of distance traveled was in Delaware).

[45] Southern Pacific Co. v. Gallagher, 306 U. S. 167 (1939); Pacific Tel. and Tel. Co. v. Gallagher,

SALES TO GOVERNMENTS AND THEIR INSTRUMENTALITIES

Governments, federal, state and local, make up a second great class of consumers constitutionally exempt from excises on purchases of materials or services. This intergovernmental exemption is, it is true, usually expressly granted by statute or regulation. Thus the miscellaneous federal excise laws exempt sales to states and their political subdivisions,[46] while under most of the state general and selective sales tax statutes, sales to the United States are exempt.[47] Whether these provisions are the free expression of legislative policy or whether they represent an acceptance of taxing limitations stemming from constitutional roots is a matter not entirely free from doubt. It cannot be said there is an exercise of legislative judgment until a provision of this type remains on the statute books after removal of constitutional bars; and, to be sure, four or five years ago the opinion that constitutional bars do exist in the field of intergovernmental excise taxation was pretty widely, if not universally, held. Developments since that time, discussed more fully below, afford adequate support for the view that the sole test of the validity of such taxation, at least in the absence of legislation by Congress, is whether or not the tax discriminates against those dealing with government.

Development of the Immunity Principle

The development and application of the doctrine of implied intergovernmental immunity, from *McCulloch v. Maryland*[48] to *Graves v. O'Keefe*,[49] for the most part involved other than sales tax cases. However, the principles forming the basis of the decisions did not differ in any essential from tax to tax; in all the assumption was that where a tax laid by the one government impinged on an activity of the other it was a forbidden interference with the carrying on of that government's functions. Indeed, it should be noted, especially of the income tax cases, that not only was the immunity implied but so also was the burden which is the basis of the immunity. In addition to this, the spread of consumption excises latterly provided occasion for several applications of formulated doctrine to this type of tax. The relaxation of the doctrine of implied governmental immunities in the income tax cases, culminating in the *Graves* case and the Public Salary Tax Act of 1939,[50] was not, therefore, without some accompaniment in the excise tax field.

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306 U. S. 182 (1939); Stanolind Pipe Line Co. v. Oklahoma Tax Comm., 113 F. (2d) 853 (C. C. A. 10th, 1940), *cert. denied*, 311 U. S. 693 (1940).

The scope of state power to impose sales and use taxes in the case of transactions of interstate character is canvassed by McNamara, *Jurisdictional and Interstate Commerce Problems in Imposition of Excises on Sales*, and Brown, *The Future of Use Taxes*, both *supra* this issue.

[46] Pistols and revolvers, INT. REV. CODE §2700(b)1; machine guns, *id.* §2721(a); manufacturers' excise and import taxes, *id.* §3442(3); communication facilities, *id.* §3446; bituminous coal (basic tax) *id.* §3522. See also admissions, *id.* §1701(a).

[47] See digests cited note 22, *supra*. Illinois is an exception. The Retailers Occupation Tax does not exempt sales to the United States. See 17 DEC. COMP. GEN. (1937-1938) 863, which distinguishes this tax from the ordinary sales tax.

[48] 4 Wheat. 316 (U. S. 1819).

[49] 306 U. S. 466 (1939).

[50] 53 STAT. 574, 5 U. S. C. A. §84a, 26 U. S. C. A. §22a, 116 (1939).

Panhandle Refining Co. v. Knox[51] held that the Mississippi gasoline tax, in form a tax on the dealer for the privilege of selling gasoline in the state, could not constitutionally be imposed with respect to a sale of gasoline by the dealer to the United States. In *Indian Motorcycle Co. v. United States*[52] it was held that the federal excise tax could not be imposed on the sale of a motorcycle by the manufacturer to a municipality, for use in its police department. A few years later, in *Graves v. Texas Co.*,[53] it was held that a state gasoline tax, in terms laid on the withdrawal of gasoline from storage, was unconstitutional as applied to a withdrawal for the purpose of making delivery on a sale to the United States. The Court viewed storage and withdrawal from storage as essential parts of the sale process, and thought that this was essentially the same type of tax it had struck down in the *Panhandle* case.

Only a year later, however, a West Virginia tax on the gross income of a contractor doing construction work for the United States was sustained by a sharply divided Court in *James v. Dravo Contracting Co.*[54] The contractor had resisted payment of the tax on the ground that the United States would be directly burdened by resultant price increases. The case was twice argued before the Court and the Solicitor General of the United States, appearing *amicus curiae* to present the view of the Government, urged that the tax be upheld. The *Panhandle, Indian Motorcycle* and *Graves* cases, not overruled in so many words by the majority opinion, were distinguished and limited to their particular facts.

The reluctance of the Court to overrule comparatively recent cases is easily understood, but it is not such an easy matter to grasp the distinction between the *Panhandle* and *Dravo* cases. A gross income tax does not differ from a sales tax insofar as the transfer of goods or services is concerned. All other conditions equal, the amount of the tax is added to the price to be paid by the consumer. As a matter of fact all state sales taxes are measured by gross receipts from sales of goods or services even though they differ as to statutory incidence. That is to say, under some of the laws the tax must be passed on to the consumer, while under others its shifting is not required, although actually it takes place. But whether the tax is or is not passed on, the state looks to the seller for the tax and his tax varies exactly with the rise and fall of his gross receipts from sales of goods or services.[55] Since a contractor selling services and materials knows in advance what the tax on his receipts will be he is no differently situated than is a retailer of commodities subject to sales tax; in both instances the tax is an ascertainable cost and must be passed on or absorbed. To say that the cost of the work to a government would not necessarily be increased because competitors might be willing to absorb the tax in their estimated profit rather than lose the contract, disregards the fact that competition on the basis of estimated costs and profits usually decides the award of the contract, even where there is no tax in the offing. Indeed, a gross receipts tax considered in

[51] 277 U. S. 218 (1928).
[52] 283 U. S. 570 (1931).
[53] 298 U. S. 393 (1936).
[54] 302 U. S. 134 (1937).
[55] See note 25, *supra*.

connection with price competition is an extremely rigid item because it is the same for all, whereas in the matter of material and labor costs one contractor may have an advantage over others.

It does not seem possible, therefore, to distinguish the *Panhandle, Indian Motorcycle,* and *Graves* cases on this basis. The vice of the *Panhandle* and *Texas Co.* cases (where the tax was not laid on the sale, nor on the United States, but rather on a seller who had contractual relations with the United States) was that the seller's tax varied directly with his total sales. This, the Court thought, was in effect taxation of the sale itself. Both the dissenters in the *Dravo* case and the Solicitor General who argued it felt that no distinction could be made between it and previous cases. The latter's view is stated by Justice Roberts as follows:[56]

> "The Solicitor General as amicus curiae proposes a single test of the constitutionality of a state tax upon the operations of the United States, or the means chosen for the execution of its powers. That test is whether the taxing statute discriminates against the government and in favor of other taxpayers. He frankly admits that if the proposed criterion be adopted we must overrule *Indian Motorcycle Company* v. *United States,* 283 U. S. 570; *Panhandle Oil Company* v. *Mississippi, supra;* and *Graves* v. *Texas Company,* 298 U. S. 393. He professes himself, as I am, unable to distinguish a sales tax or a tax upon storage preliminary to sale to the United States from a gross receipts tax upon goods and services furnished the government."

The Comptroller General, in common with other federal departmental officers, still regards the *Panhandle* case as controlling.[57] Although this has caused some controversy in a few instances, the conflict which would naturally arise from a diversity of view[58] as to the status of the *Panhandle* case has been avoided to a certain extent because of the fact that many state excise statutes or regulations specifically exempt sales to the United States and their instrumentalities. Developments in connection with cost-plus-a-fixed-fee contractors, discussed more fully below, show that this general situation remained pregnant with possibilities for confusion.

A few state court decisions have sanctioned the imposition of their sales taxes on receipts from sales to instrumentalities of the United States. In California the sales tax, construed as a tax on the seller, was upheld as applied to receipts from sales to a national bank.[59] The North Dakota gasoline tax has been sustained in its application to purchases by a federal land bank.[60] In March of this year the same court held the bank liable for the state sales tax on lumber which it purchased to repair property acquired through foreclosure.[61] Conceding that the tax was on the

[56] James v. Dravo Contracting Co., *supra* note 54, at 170. In its brief the United States had asked "that this Court reconsider its decisions in the *Panhandle, Indian Motorcycle* and *Texas Company* cases and that it extend to the taxing authorities of both the Federal and State governments the latitude which the basis of the doctrine of sovereign immunity from taxation seems properly to permit."

[57] 18 DEC. COMP. GEN. (1938-1939) 832; 19 *id.* (1939-1940) 1, 822. See also 17 *id.* (1937-1938) 863, and compare 19 *id.* (1939-1940) Opinion A-88689, Feb. 28, 1940, distinguishing the Illinois and California sales taxes.

[58] See 39 OP. ATT'Y GEN. (1939) 6.

[59] Western Lithograph Co. v. State Board of Equalization, 11 Cal. (2d) 156, 78 P. (2d) 731 (1938).

[60] Federal Land Bank of St. Paul v. DeRochford, 69 N. D. 382, 287 N. W. 522 (1939).

[61] Federal Land Bank of St. Paul v. Bismark Lumber Co., 297 N. W. 42 (N. D. 1941), *cert. granted,* at request of Solicitor General, 61 Sup. Ct. 1105 (1941).

consumer and not a privilege tax on the seller, the court held that the tax was on a transaction growing out of activities of a non-governmental nature, and that the immunity, express or implied, extended only to those operations of the bank which were of a governmental nature.

The second land bank decision may be vulnerable at several points. First, the Supreme Court has placed stress on the form or statutory incidence of state sales taxes. For example, in upholding the New York City sales tax as applied to interstate shipments, the Court pointed out that the tax was on the buyer and not unlike a use tax.[62] Again, in *Colorado National Bank v. Bedford,*[63] the Court emphasized the fact that the "service" tax in suit was to be paid by the consumer, although the national bank which furnished the "service" (*i.e.,* rented a safe deposit box) was required to collect the tax for the state from the consumer. Had the tax been on the bank it would have violated *Revised Statutes* Section 5219 which limits state taxation of national banks to several specified methods.

In the three cases just mentioned the tax differs in form from that involved in the *Dravo, Texas Co.* and *Panhandle* situations where the tax was in terms imposed on the seller. Economically, there apparently is no difference; in both situations the tax is commonly shifted. However, if the criterion of constitutionality is that the tax be not directly imposed on the United States as buyer, the difference in statutory incidence is important and the "consumer" type of sales tax would be unconstitutional as applied to purchases by the United States. On the other hand, if the criterion of validity is that attributed to the Solicitor General in the *Dravo* case, that is, one of whether the taxing statute discriminates against the government and in favor of other taxpayers, the statutory incidence should not be governing. At least, it should not be governing to a Court which apparently has both eyes cocked for "realities" in tax cases.[64]

Whether there is any virtue in the distinction between the governmental activities of the bank and its additional non-governmental activities, is doubtful. Since the Court has said that all the constitutional activities of the United States are governmental activities,[65] it seems quite unlikely that where a federal department or agency is concerned, it will revert to governmental-proprietary distinctions to decide a case of this type. However, even when such distinctions have formed the basis of the immunity it has been held that the primary purpose of the instrumentality was controlling.[66]

The most important fact about the North Dakota case is that Congress has exempted land banks from all taxation except on the real property which they own.[67] While under ordinary circumstances at any rate, one may question the

[62] *Cf.* note 25, *supra.*

[63] *Supra* note 25.

[64] *See* for example in the present term, Helvering v. Horst, 311 U. S. 112 (1940); Helvering v. Eubank, 311 U. S. 122 (1940); Wisconsin v. J. C. Penney Co., 311 U. S. 435 (1940); Superior Bathhouse Co. v. McCarroll, 312 U. S. 176 (1941); Helvering v. LeGierse, 312 U. S. 625 (1941).

[65] Pittman v. Home Owners' Loan Corp., 308 U. S. 21 (1939).

[66] New York *ex rel.* Rogers v. Graves, 299 U. S. 401 (1936).

[67] 39 STAT. 380 (1916), 12 U. S. C. §§931-33 (1934).

fairness of permitting a government corporation to engage in competitive enterprise while at the same time favoring it with a tax differential, nevertheless it appears that if Congress deems this condition necessary or desirable its action in the matter is conclusive.[68]

Post Exchanges

Two comparatively recent problems have appeared to focus attention anew on the question of intergovernmental immunities. The first involves the taxation of sales to or by post exchanges and similar voluntary unincorporated organizations of army and navy personnel.[69] Although not created by statute, post exchanges are operated under regulations[70] prescribed by the Secretary of War and most of them are located on lands over which the United States has exclusive jurisdiction. They are authorized to sell articles of common use to soldiers and other personnel of the camp or reservation where they are located. No private gain inures from their operation, the allowed profit going to the common funds of the companies or units which compose the post exchange.

With the passage of the Buck Act in 1940,[71] the territorial tax immunity of transactions taking place on federal reservations was removed, but that immunity is not waived where sales by a federal instrumentality are concerned. Under this act, therefore, the liability for taxes of the post exchange or of authorized purchasers from post exchanges depends expressly on whether the post exchange is a federal instrumentality.[72] The cases conflict on the status of these exchanges.[73] A recent decision, *United States v. Query*,[74] held an exchange to be a federal instrumentality and enjoined the South Carolina Tax Commission from enforcing its license tax (really a sales tax) on goods sold by the exchange. Previously in 1937, in a similarly entitled case, the same conclusion was reached with respect to a post

[68] "In the exercise of this power to protect the lawful activities of its agencies, Congress has the dominant authority which necessarily inheres in its action within the national field." Pittman v. Home Owners' Loan Corp., *supra* note 65, at 33.

[69] These consumption taxes would eventually be paid by the consumer or purchaser from a post exchange. However, if in the case of cigarettes and beer the exchange refuses to buy taxpaid commodities, or in the case of the general sales tax to collect and pay the tax to the state, the consumer is relieved of the tax. On the status of the post exchange depends the consumer's liability for tax.

[70] A. R. No. 210-65, C-1, C-3. For other types of associations see War Dept. Circular No. 13, Jan. 21, 1941.

[71] 54 STAT. 1059, 4 U. S. C. A. §§12 *et seq.* (1940). Congress had previously required post exchanges to collect and remit to the states, gasoline taxes on motor fuel sold for other than the exclusive use of the United States. 49 STAT. 1521, 4 U. S. C. A. §12 (1936).

[72] Section 3 of the Buck Act states: "The provisions of . . . this Act shall not be deemed to authorize the levy or collection of any tax on or from the United States or any instrumentality thereof, or the levy or collection of any tax with respect to sale, purchase, storage, or use of tangible personal property sold by the United States or any instrumentality thereof to any authorized purchaser." 54 STAT. 1060, 4 U. S. C. A. §15 (1940).

[73] Federal administrative officials have held the post exchange to be a federal instrumentality. See the opinion of the Attorney General, *supra* note 58; War Dept. Circular No. 13, *supra* note 70; and the instances cited in United States v. Query, *infra* note 74. To the same effect are rulings of the attorney generals of Alabama (Dec. 31, 1940) and Ohio (Jan. 24, 1941). The attorney generals of Connecticut (Dec. 30, 1940), New York (Dec. 23, 1940) and Texas (May 7, 1940) take the opposite view. See Fed. Tax Adm'rs, *Status of Voluntary Associations of Service Personnel for Tax Purposes* (1940).

[74] 37 F. Supp. 972 (E. D. S. C. 1941).

exchange operated in conjunction with a Civilian Conservation Corps camp.[75] The creation of C. C. C. post exchanges is expressly authorized by statute but no immunity from taxation is granted.[76] In addition to these cases, the United States Court of Claims has also held that post exchanges are federal instrumentalities.[77] The opposite view, that a post exchange is simply a voluntary cooperative organization of individuals, has been taken by the Fifth Circuit court of appeals and the supreme court of California.[78]

The tax liability of vendors for goods sold to post exchanges is governed by the same considerations discussed in connection with the *Panhandle* and *Dravo* cases.[79] As a practical matter the state tax administrator cannot force the collection of tax on sales to post exchanges. If the post exchange refuses to pay the tax the dealer, usually a wholesaler, is faced with the alternatives of absorbing the tax or turning away the custom since the post exchange can buy supplies tax free simply by ordering them from outside the state.[80] Because the tax may be rather high on an *ad valorem* basis, the effect of attempted enforcement is to deprive local sellers of the exchange's custom. Precisely for this reason several states have had to revise their rulings to exempt sales to post exchanges, and three states, New York, Pennsylvania and Texas, have by statutes enacted this year granted similar exemptions.[81]

Cost-Plus Contractors

To push the defense program forward as quickly as possible, the United States is authorized, under certain conditions,[82] to enter into cost-plus-a-fixed-fee contracts.[83] Since under most sales tax statutes the contractor is regarded as the consumer of the materials he buys, the seller is liable for sales taxes on materials bought in fulfillment of these contracts and, of course, adds the tax to the contractor's invoice. Some of the earlier contracts specifically included applicable state and local taxes as allowable costs for purposes of reimbursement to the contractor,[84] but contracting officers now refuse to recognize a state sales tax as an allowable cost.[85] The ground

[75] United States v. Query, 21 F. Supp. 784 (E. D. S. C. 1937).

[76] 50 STAT. 320, 16 U. S. C. A. §584(c), (p) (1937).

[77] Dugan v. United States, 34 Ct. Cl. 458 (1899); Woog v. United States, 48 Ct. Cl. 80 (1913).

[78] Pan American Petroleum Corp. v. Alabama, 67 F. (2d) 590 (C. C. A. 5th, 1933); People v. Standard Oil Co. of California, 218 Cal. 123, 22 P. (2d) 2 (1933), *rev'd* on another ground *sub. nom.* Standard Oil Co. of California v. California, 291 U. S. 242 (1934). *Accord:* Keane v. United States, 272 Fed. 577 (C. C. A. 4th, 1921).

[79] The Attorney General, though holding post exchanges to be federal instrumentalities, has recommended that the Federal Government take no part in any effort to collect taxes from dealers selling to post exchanges. Opinion of the Attorney General, *supra* note 58.

[80] Sales requiring shipping to points outside the state are in all jurisdictions exempt from general and selective sales taxes.

[81] N. Y. Laws 1941, c. 351; Pa. Laws 1941, act No. 34; Tex. Laws 1941, S. B. No. 91.

[82] 53 STAT. 590, 34 U. S. C. A. §556, 53 STAT. 652, 5 U. S. C. A. §118(e) (1939); 54 STAT. 676, 712, 50 U. S. C. A. App'x 1, 2 (1940).

[83] For a description of this type of contract see U. S. Navy Dep't, Bureau of Yards and Docks, *Some Commentaries on Cost-Plus-a-Fixed Fee Contracts* (1940).

[84] See the discussions in Fed. Tax Adm'rs, *Status of Cost-Plus Contractors with the United States* (1940); Nat. Ass'n of Manufacturers' Law Digest, *National Defense Contracts* (Oct.-Nov. 1940).

[85] U. S. Navy Dep't, *supra* note 83, at 18.

for the refusal is that the cost-plus contractor is merely an agent of the United States and that the *Panhandle* case prevents a tax on sales to the United States. Much reliance is placed on the fact that the United States takes title to all materials delivered to the contractor, although there is some evidence that the title-taking provision was primarily intended to minimize insurance costs by removing the risk of loss from the contractor. Some of the contracts have also required prior approval of the government officer on any orders for materials costing in excess of $500.

Only one court has thus far ruled on the taxability of such sales. The supreme court of Florida held that a distributor of gasoline is liable for the state gasoline tax on motor fuel sold to a cost-plus contractor fulfilling a defense contract with the United States.[86] The court inclined to the view that the *Panhandle* case was no longer controlling but also emphasized the fact that the particular contract itself provided that all applicable state and local taxes should be allowable costs to the contractor. Of some bearing, however, is the further case of *Boeing Airplane Co. v. Comm. of Revenue and Taxation*,[87] where the Kansas supreme court held that state sales or use taxes might be imposed on materials bought by an airplane manufacturer to construct an emergency defense airplane plant. Title to the plant was in the manufacturer's name but was to be transferred to the United States in five years, at which time the Government would have reimbursed the manufacturer for the cost of the plant.

Administrative rulings on the liability of cost-plus contractors to sales tax are by no means uniform.[88] The North American Gasoline Tax Conference, considering the matter at its 1940 meeting,[89] approved the view that the cost-plus contractor was essentially an independent contractor rather than an agent of the United States and, therefore, liable for motor fuel taxes under the holding in *Trinity Farm Construction Co. v. Grosjean*.[90]

A recent statement of the policy of the Department of Justice, however, indicates an opposing position. Acting Attorney General Biddle in a memorandum under date of June 5, 1941, has declared that the Department views the cost-plus-a-fixed-fee contractor as an instrumentality of the United States, and will contest the imposition of taxes whose legal incidence is on the contractor as purchaser. Also challenged are those sales taxes which the seller is directed by statute to collect from the purchaser or to pass along to the purchaser. This is, of course, on the theory that the legal incidence of these taxes falls directly on the United States. Pursuant to this policy the Federal Government has become a party plaintiff in one case and has intervened in another, both in Alabama, where sales and use tax assessments have been made against a merchant selling to a cost-plus-a-fixed-fee contractor. In *United States, Dunn Con-*

[86] Standard Oil Co. v. Lee, 142 Fla. 906, 199 So. 325 (1940).
[87] 113 P. (2d) 110 (Kan. 1941).
[88] TAX ADMINISTRATORS NEWS (Jan., Feb., March, April, 1941).
[89] PROC. NORTH AMER. GASOLINE TAX CONF. (1940) 79-82.
[90] 291 U. S. 466 (1934).

struction Co. et al. v. Curry, and *King and Boozer v. Alabama,* the circuit court of Montgomery County, Alabama, on June 13, 1941, upheld imposition of the state's sales and use taxes. An authoritative determination of the question by the United States Supreme Court early in the 1941 term may thus be possible.

If the test be statutory incidence, the line of demarcation between valid and invalid taxes under the implied intergovernmental immunity rule will be easily but not satisfactorily drawn. For example, the omission of the shifting provision in some state sales tax laws will convert them into occupational or privilege taxes as far as legal incidence is concerned. However, if the shifting continues, and experience and business practice indicate that it will, the effect in dollars and cents on the government which contracts or purchases will remain unchanged. For a clear-cut solution of this problem it seems necessary to recognize that a genuine public immunity and not a private immunity is involved in cases where excise taxes on sellers to or contractors with governments are concerned. The decision then to be made is whether governments are to bear the increased costs that result from taxes which are segregable in fact rather than in legal incidence.

Congress has on at least two occasions refused to exercise the power accorded it by the recent Supreme Court determinations to exempt from federal, state and local taxation materials used by these cost-plus contractors. In both instances the legislation authorizing the use of cost-plus contracts carried language that would have made the contractors agents or instrumentalities of the United States.

Proprietary Activities of the States

Because all constitutional activities of the United States are judicially conceived to be governmental,[91] there is little likelihood that the governmental-proprietary distinction will sustain the validity of a state or local tax impinging on some federal activity. This distinction, however, does serve as the basis for upholding federal taxes on the activities of states and local governments. State monopoly systems for dispensing liquor, and state university athletic exhibitions to which an admission fee is charged furnish instances where federal taxes must be paid on activities conducted under governmental authority.[92] It might also be noted here that states and their political subdivisions must pay federal taxes which in terms are not imposed on sales even though it is obvious that the tax is passed on and might easily be segregated. For example, the federal cigarette tax, amounting now to six and one-half cents per package, is imposed on the manufacturer of cigarettes. The Supreme Court has upheld the inclusion of this amount in the price paid by a state for cigarettes purchased for use in its public institutions, without considering whether the operation of a hospital was a governmental activity.[93]

[91] Pittman v. Home Owners' Loan Corp., *supra* note 65.

[92] South Carolina v. United States, 199 U. S. 437 (1905); Ohio v. Helvering, 292 U. S. 360 (1933); Allen v. Board of Regents, 304 U. S. 439 (1938).

[93] Liggett and Myers Tobacco Co. v. United States, 299 U. S. 383 (1937).

ADMINISTRATION OF EXEMPTIONS AND REFUNDS

When a class of consumers is relieved of excise taxes there are two ways in which the privilege may be made effective. The sale may be exempted in the first instance so that no tax is ever paid on it or payment of the tax may be required in the first instance and a refund or reimbursement made later. In connection with general and selective sales taxes, except the tax on gasoline, the exemption method is commonly used. Under the gasoline tax the refund system has generally been adopted except on sales to the United States. The exemption method is more acceptable to the taxpayer since he does not have to go to the trouble of applying for a refund. It is less satisfactory to the administrator though, unless exemption certificates are secured on every sale and even then there remains a great possibility of evasion.[94]

The general sales tax is better adapted to the use of the exemption than is the gasoline tax for two principal reasons. First, the primary responsibility for the sales tax rests on the retailer who makes the sale to the consumer; in other words, it is on the last seller to the taxpayer. When, therefore, he sells the goods he knows whether the buyer is of the exempt class. Hence to put the exemption into operation the retailer merely excludes the proceeds of that sale from his ordinary taxable receipts. Under the motor fuel tax the first handler, usually called the importer or distributor, is ordinarily liable for the tax. When he sells to a sub-distributor and the latter to a dealer and so on down the line until the fuel is finally sold to a consumer, the tax is included because at the time the distributor makes the first sale and adds the tax, he does not know what type of consumer will eventually buy the gasoline. The second reason for the difference lies in the relative rates of the two taxes expressed on an *ad valorem* basis. The general sales tax rate is only two or three per cent. The lowest gasoline tax, two cents per gallon, is more than ten per cent of the retail price on an *ad valorem* basis, while some of them run over 25 per cent. This greater incentive to evasion in connection with a commodity in such wide use as gasoline makes it necessary for the gasoline tax administrator to check exemptions and refunds very carefully lest the tax base be seriously diminished.

When the exemption method is used the seller may be required to support his deduction for non-taxable sales by an exemption certificate signed by the buyer. The United States furnishes such a certificate (Standard Form 1094) on its purchases. This is accepted in lieu of the tax by the seller and is in common use under all types of sales taxes, including the gasoline tax. Sometimes copies of the invoices are required to accompany Form 1094 in support of the deduction while in some states copies of the invoices alone are required. Some administrators require the invoice on the ground that it is better proof of the sale and delivery to the Government than is Form 1094 because the latter might possibly be obtained and used by unauthorized persons and might also be used to cover a number of individual transactions. Where

[94] For a general treatment see, JACOBY, RETAIL SALES TAXATION (1938) *passim;* CRAWFORD, *loc. cit. supra* note 10; Report of the Kansas Legislative Council, *Gasoline Tax Exemptions* (1937); ANN. PROC. NAT. ASS'N TAX ADM'RS; ANN. REP. NORTH AMER. GASOLINE TAX CONF.

sales are made to others than consumers the deduction may sometimes be taken without explicit proof of the sales tax return. The seller is required to keep copies of his invoices, delivery sheets and other such memoranda on file in his office and these are checked by auditors and investigators in their periodic examinations.

Exemption procedure when used in connection with the gasoline tax usually requires the user to secure a permit to buy gasoline tax free. This requirement may also apply to a seller of exempt fuel. The invoice must have the permit number of the buyer, and in addition the buyer may be required to sign a manifold exemption slip, one part of which he keeps and the other the seller retains to substantiate the deduction he takes on his return. At least three states use the exemption method at the present time, Kansas, North Dakota and Oklahoma. The latter originally used the exemption system, changed to the refund and finally returned to the exemption system after a more carefully considered procedure had been worked out for administration.

While the present Oklahoma system seems to provide an adequate check on evasion, the exemption method for gasoline has been abused in several states and tax administrators generally favor the refund method for other than sales to the United States. The simplest form of refund procedure required only that the purchaser make claim for the refund under affidavit setting forth the gallonage used and the tax, supported by a copy of the invoice. Continuous development of stricter procedures has led to many refinements during the past decade. In some states a permit to use gasoline for refundable purposes must be secured or no refund may be obtained. Pertinent information as to the type and extent of use must be furnished. From this it is possible to work out a quota for the user. This quota, although only an approximation, nevertheless serves as an indicator and fluctuations in it may warrant the sending of a field investigator for a check-up. The refund claim must usually be filed within a specified time and in some states, to avoid a multiplicity of small refund checks, must be for a minimum number of gallons. In some states the purchase of refund fuel must be made in specified lots. The use of coloring for refund fuel and segregation of it in special tanks have also been adopted as methods of preventing evasion of the tax through use of the refund privilege. Another requirement to prevent fraud is that the purchaser of refundable fuel state at the time of purchase that it is bought for this purpose, notation on the invoice being necessary to securing of a refund.

SPECIAL PROBLEMS IN THE LEVY OF MUNICIPAL EXCISE TAXES

Seymour Graubard*

Decreasing assessed valuations of realty, new services and the impact of relief needs have made it necessary for municipalities to obtain additional revenues. Traditionally bound to a real estate tax as the chief source of income, the cities have found it necessary during the past decade to experiment with excise taxes. In New York City, for example, the assessed valuations of real estate for tax purposes have dropped nearly four billion dollars, thus resulting in the loss to the city of some 80 millions of dollars in potential taxes within the state constitutional tax limit of two per cent on assessed valuations. The real property tax continues to be the largest source of local revenues but annually shows a small decline in the percentage of the total receipts of municipalities. It is estimated that approximately 18 per cent of the total collections of cities, aside from state grants, now comes from excise taxes, license fees and miscellaneous revenues.[1]

There is no one pattern followed by the cities in imposing excise taxes. The types of taxes used by each local community vary with the particular economic problems of the community and the extent of its powers under the provisions of its state constitution and the acts of its state legislature. The most common of the municipal excises are the sales tax and the gross receipts tax; but it must be borne in mind that a tax of this character may be called a "stamp tax," following the manner of its payment, a "cigarette tax," because of its limited tax base, a "license tax," "utility tax," "amusement tax" or "turnover tax," or there may be employed the variety of names such as are used by the West Virginia cities of Bluefield, Charlestown, Huntington and Morgantown.

These municipal taxes, whatever their designation, present in large measure the same legal and administrative problems as fall upon the states which employ like levies. But because the physical areas of cities are relatively small, and because municipal corporations depend for their powers on their state legislatures, they have certain additional and distinctive problems to face, which it is the purpose of this article to present. Emphasis is given to the experience of New York City, which has pioneered in the imposition of municipal excise taxes and whose leadership has been

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[1] Lepawsky, *Municipal Revenues* (1940) 7 Mun. Year Book 170, 172.

followed to some degree by other cities in the nation.[2] To determine the place that these local taxes should occupy in the over-all tax structure of the nation is beyond the scope of this article, although the issues and facts analyzed have lead to some conclusions which are briefly mentioned. The particular problems to be discussed are: (1) the geographic and economic factors which determine the types and rates of municipal taxes; (2) the legal limitations imposed by the states on the power of cities to levy excise taxes; (3) the extent to which the municipality may tax intrastate activities which originate or conclude outside the taxing municipality; and (4) the advantages and disadvantages of municipal administration of excise taxes.

ECONOMIC FACTORS DETERMINING TYPES AND RATES OF MUNICIPAL TAXES

Disregarding internal political pressures, which after all are common to both state and city alike, the one problem emphasized in the consideration of local excises is that of the extent to which the tax will harm the business of the city in intercity competition. The experience of Philadelphia, which in November, 1938, repealed a nine-months old two per cent sales tax, has been described by an assistant solicitor of that city in a way that highlights this issue:[3]

> In order to understand this situation, it is necessary to realize that immediately across the Delaware River is located the City of Camden, N. J., which is a fairly large industrial city and has a number of shopping centers and that in Delaware County, which adjoins Philadelphia, there is a large settlement known as "The 69th Street Section" which was originally built up because of the fact that Philadelphia did not permit the showing of moving pictures on Sunday. That Section did and, as a result of the traffic to it, the settlement in the past ten years has grown to such an extent that one large department store has opened a branch there and others are considering doing so. They have reaped a harvest as a result of the trade driven from the City to that section. In addition to this, we are within ninety miles of the great City of New York and on substantial purchases, the amount of tax justifies the trip. As an example, if a woman is desirous of purchasing a fur coat at a price of approximately $300 the tax of $6.00 which she would have to pay in Philadelphia, would pay the cost of her trip to New York and return, thus giving her the benefit of the greater market which exists in New York City, plus the benefit of all other attractions of a holiday in that city, the expenses, of course, being borne by the merchants of the City of Philadelphia. The experience of the City Solicitor's office in connection with the enforcement of this ordinance has shown that while it is a lucrative tax for the City in its initial stages, the revenue already raised being in excess of $2,000,000, it has driven business outside the City to such an extent that the original estimate of a 35% loss, made by the merchants when they appeared in opposition to the tax, seems conservative. Even if the tax should not be imposed during the next year, the buying habits thus created will be difficult to overcome, so that in the long run, the city will lose as much as it gained.

While this graphic description of Philadelphia's plight must be deemed somewhat exaggerated in its estimates of loss of business, there is no question about the importance of the size and location of the municipality in determining whether to impose a sales tax. Los Angeles, with its population of 1,500,000 and its area of 450

[2] For a detailed presentation of New York City's imposition of excise taxes in 1933-1934, see Baum, *Legal Phases of Local Sales Tax* (1936) 14 N. Y. U. L. Q. REV. 28; Chanler, *Local Taxation for Relief*, in MCINTIRE AND RHYNE, MUNICIPALITIES AND THE LAW IN ACTION (1938) 111.

[3] Shapiro, *Philadelphia Revenues*, in MCINTIRE AND RHYNE, *op. cit. supra* note 2, at 33-34.

square miles, is in a better position to levy such a tax than is Philadelphia, whose 2,000,000 residents live within an area of 129 miles; and the merchants of New York City, which has a population of 7,500,000 and 320 square miles of land, can far better afford a sales tax than can the tradesmen of the neighboring City of Hoboken, N. J., whose 50,000 inhabitants are cramped within an area of less than two square miles.

The measure of safety from trade diversion is the distance and ease of communication between the shopping center of the taxing city and those of non-taxing cities. A city large in area may lose business to competing shopping centers, particularly if many of its residents work or live a short distance from the municipal frontiers. In the middle eastern states and the southern portion of New England, only politically maintained boundary lines separate the thickly populated sections of two or more cities, and the residents of one often find it more convenient to make their purchases across the boundary line. Even New York City, with the Hudson River and the Atlantic Ocean along an extensive portion of its perimeter, has found that those of its merchants who were located near adjacent counties had good reason to complain against the effects of the city sales tax. Some of the storekeepers are able to retain their customary business only by absorbing reductions in prices equivalent to the amount of the sales tax.

On the other hand, a city may be small in area and still be able to impose a sales tax, provided that there is no other city near by to serve as a shopping center. Particularly in the west and midwest, where distances are great between cities, the impositon of a sales tax will not result in any considerable diversion of business. The cost in time and money of travelling to another city cannot be made up in savings on sales tax payments.

Diversion is further discouraged in these sections of the country by reason of the fact that the cities exist as the merchandising and manufacturing centers of more or less sparsely settled areas. They provide a variety of goods which the small town or village store is unable to supply. Furthermore, because their merchants do a large volume of business, their prices are generally lower, even with a two or three per cent sales tax added, than are those in the small communities. Finally, the habit of shopping in a metropolitan district, with its concomitant opportunities of visiting places of amusement and of cultural interest, is not easily broken. Despite Philadelphia's experience, it is believed that trade diversion due to the sales tax in New York City amounts to but a small fraction of one per cent of the business done. While the adoption of the compensating use tax has accounted in part for the retention of sales volume, particularly as regards automobile sales, the fact is that the attractiveness of the city's combined variety of shops, department stores and sales agencies has proved a greater lure than the lack of a sales tax in the adjacent communities.

The intercity competitive aspects of the gross business tax differ somewhat from those of the sales tax. Here we deal with an impost, generally amounting to a fraction of one per cent, which in practice must be absorbed by the manufacturer, wholesaler, warehouseman, broker and retailer. The intercity threat in this case varies directly with the rate of the tax, and the penalty for a harsh tax can be the loss of

manufacturing or marketing enterprises. When in 1933 the City of New York announced plans for imposing a four cent transfer tax on stock and a five per cent tax on the gross income of stock brokers, the New York Stock Exchange leased premises for a new exchange across the Hudson River in New Jersey. The tax was abandoned, for the proposed tax rate was punitive. But when stockbrokers, along with all other brokers in the city, were subsequently taxed at a rate of one-fifth of one per cent of their gross income, few complaints and no threats were heard.

Manufacturers in New York City took in stride the gross receipts tax of one-tenth of one per cent, but certain of them organized to protest the application of the tax to their interstate business, even though the maximum rate applicable to such transactions was one-fifteenth of one per cent. In their petition to the City Comptroller for an adjustment of the tax rate, these manufacturers pointed out that they were engaged in quantity production of low priced garments in a national market, with competition from manufacturers all over the country, and that they often had to work on a two per cent profit margin. So long as the tax was confined to their sales in New York City alone, where they had practically no competition from outsiders, they had no valid objection; but to shoulder them with a tax, which, though small in rate, was high in proportion to their gross profit, they felt put them to a bad competitive disadvantage. The Comptroller granted their petition to the extent of halving the tax rate on interstate sales. However, at no time was there any danger of a wholesale exodus of these manufacturers from the city. The benefits of a skilled labor market, good transportation, access to raw materials and power—found in all manufacturing centers as to some types of industry—were too great to be surrendered because of the tax.

Where the business taxed is conducted entirely within the area of the taxing city, the rate of the tax may, of course, be increased with little danger of business loss. Thus a retailer, who is dependent for his trade upon the location of his store, cannot run away from a gross business tax without giving up his business. Furthermore, as the rate of gross profit of the retailer is generally greater than that of the manufacturer or wholesaler, he can absorb a higher rate of tax. This principle has been applied in several states.[4] Public utilities too, retailers of power, light, heat, refrigeration and

[4] Because most states impose a variety of tax rates for particular trades or industries, only the dominant tax rates are set forth below. The taxes on retail sales may be intended either as a consumers sales tax or as a gross business tax, but for the purposes of this comparison no distinction is made.

Taxing Jurisdiction	*Rate of Tax*		
	Retail Trades	*Wholesale*	*Manufacturing*
	%	%	%
Arizona	2	0.25	1
Delaware	0.1	0.2	0.025
Indiana	1	0.25	0.25
Mississippi	2	0.125	0.25-1
New Mexico	2	0.125	0.25
North Carolina	3	0.05	—
Pennsylvania	0.1	0.05	—
West Virginia	0.5	0.15	0.3

transportation on a grand scale, must stand and bear the gross business tax when imposed at a high rate. Originally taxed by New York City in 1933 at a rate of one and one-half per cent of their gross receipts, they had to pay the city three per cent of their revenues in 1934.[5] It is manifestly impossible for public utilities to move elsewhere; they therefore provide an economically desirable base for municipal taxes.

LEGAL LIMITATIONS ON MUNICIPAL TAXING POWER

The Congress, when it imposes a tax, must keep in mind the restrictions of the Federal Constitution, and a state legislature must consider as well the extent of its powers under the state constitution. But the draftsman of a municipal tax has not only to cope with these factors; he must also contend with the fact that while a few state constitutions have been interpreted to hold that a municipality may impose taxes without the need of obtaining particular permission to do so from the legislature,[6] the great majority of municipalities must depend for their taxing powers upon a delegation of authority from the state legislatures.[7] Thus New York's present constitution forbids a municipality to tax without first receiving from the legislature express authorization to collect a specific type of tax in a specified manner.[8] Even in the small number of states where the greater municipal power obtains, legal identicalness or close similarity of a local and a state tax will cause the former to fall unless the legislature has specifically authorized its imposition in addition to the state tax.[9] Furthermore, the degree of home rule for municipalities for which most state constitutions provide is paralleled by corresponding restrictions against discriminatory legislative treatment of any one locality or political subdivision.[10]

No general rule may therefore be laid down as to the extent of municipal taxing powers. Each city must be considered *sui generis,* and the litigant attacking the validity of a municipal excise must look not only to the provisions of the state constitution, but as well to those of the city charter, the enabling act and other statutes which may be applicable. Delegation of taxing powers is commonly effected either through an enabling act or by an amendment to the city's charter. An enabling

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[5] New York State took over this tax in 1937 at a two per cent rate, but permits all cities to tax utilities an additional one per cent. N. Y. Laws 1937, c. 321, §2.

[6] West Coast Advertising Co. v. City and County of San Francisco, 14 Cal. (2d) 516, 95 P. (2d) 138 (1939); State *ex rel.* Zielonka v. Carrel, 99 Ohio St. 220, 124 N. E. 134 (1919).

[7] 1 COOLEY, TAXATION (4th ed. 1924) §102; 4 DILLON, MUNICIPAL CORPORATIONS (5th ed. 1911) §1376; MCQUILLIN, MUNICIPAL CORPORATIONS (2d ed. 1936) §2523; MCGOLDRICK, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE, 1916-1930 (1933) 340. See also cases cited *infra.* Note also that a license fee, exacted only to cover the costs of regulating some activity and not for revenue purposes, is not a tax and is generally held to be within the municipality's police powers; see, for example, Jacobs v. Mayor and City Council of Baltimore, 172 Md. 350, 191 Atl. 421 (1937).

[8] N. Y. CONST. art. xvi, §1.

[9] See City of Cincinnati v. Amer. Tel. & Tel. Co., 112 Ohio St. 493, 147 N. E. 806 (1925), where a local occupation tax, passed subsequent to a state excise tax based on gross receipts, was held invalid; State *ex rel.* Greeson v. Roberts, 126 Fla. 114, 170 So. 457 (1936), where a local tax on slot machines, adopted prior to a similar state tax, was held invalid.

[10] MCBAIN, THE LAW AND PRACTICE OF MUNICIPAL HOME RULE (1916) 48-55.

statute delegates power, as the legislature sees fit, to all cities in the state, to a class of cities or to a single city.[11] Of course, where the delegation is contained in the charter, the power derived from that instrument is unique to that city, although most municipal charters in each state follow a standard pattern.

The scope of the taxing power delegated will thus vary widely. Before the present New York constitution went into effect in 1938, New York City received the broadest powers possible "to adopt and amend local laws imposing in any such city any tax which the legislature has or would have power and authority to impose."[12] But such an enabling act is rare. More common is a qualified grant which either describes the types of taxes that may be levied or which excludes certain activities or properties from taxation. Thus the charters of West Virginia cities authorize them "to license, tax, regulate or prohibit . . ." certain activities and businesses "... on which the state does or may exact a license tax." The Pennsylvania Sterling Act,[13] on the other hand, permits certain cities to levy taxes on "persons, transactions, occupations, privileges, subjects and personal property . . . except that a city cannot tax privileges, transactions, subjects or occupations or personal property which is now or may hereafter become subject to a state tax or license fee." Both these grants have resulted in considerable litigation.[14]

Certainly, any municipality struggling for additional revenues should take care to obtain as broad a grant of taxing power as possible from the state. The courts view local excise taxes, which are comparative innovations in the economic life of the nation, with a measure of suspicion of the motives, prejudices and common sense of the local councils. But caution in not overreaching is also necessary, lest the enabling act or charter provisions be attacked on the ground that they attempt to delegate to the municipality "the functions of the legislature." Of interest in this regard is the recent case of *Mouledoux v. Maestri*[15] concerning the validity of a two per cent New Orleans sales tax patterned on the New York City model. By distinguishing between a constitutionally forbidden "surrender of the taxing power vested in the Legislature

[11] For examples of such enabling acts, see N. Y. GEN. CITY LAW §20-B; N. Y. Laws 1933, c. 815; PA. STAT. ANN. (Purdon, Supp. 1940) tit. 53, §4613 (the Sterling Act).

[12] N. Y. Laws 1933, c. 815, §2. Under the present New York constitution, cited note 8, *supra*, the legislature is required to "specify the types of taxes" it delegates in the enabling act.

[13] Cited *supra* note 11. See also W. Va. Acts 1st Ex. Sess. 1933, c. 33; *id.* 2d Ex. Sess. c. 161, ¶6.

[14] Compare S. S. Kresge Co. v. City of Bluefield, 117 W. Va. 17, 183 S. E. 601 (1936), where a one per cent sales tax was held unauthorized, with Mullens v. City of Huntington, 117 W. Va. 740, 188 S. E. 120 (1936), holding valid a "license tax" based on the gross receipts of retail stores. Compare also People's Natural Gas Co. v. City of Pittsburgh, 317 Pa. 1, 175 Atl. 691 (1934), where a tax on the use of utility meters was rejected on the ground that it was a property tax forbidden under the terms of the Sterling Act, with City and County of Philadelphia v. Samuels, 338 Pa. 321, 12 A. (2d) 79 (1940), holding that a 10 per cent tax on the gross receipts of open parking lots was an excise and not a property tax.

In Ploch v. City of St. Louis, 345 Mo. 1069, 138 S. W. (2d) 1020 (1940), the court held that a state sales tax law, enjoining any city from imposing any levy directly or indirectly on the sale of personal property, did not prohibit a city from adopting an occupation tax which taxed cigarette merchants on the basis of their gross sales of cigarettes. In City of Pensacola v. Lawrence, 126 Fla. 830, 171 So. 793 (1937), the enabling act provision, authorizing the city to levy license taxes upon any and all occupations and privileges, was deemed not to permit a two per cent tax on the sale of real estate.

[15] 2 So. (2d) 11 (La. 1941). See also N. Y. Steam Corp. v. City of New York, 268 N. Y. 137, 197 N. E. 172, 99 A. L. R. 1157 (1935).

by the Sovereign State" and a permissive "delegation by the Legislature of the power to tax," the Louisiana supreme court was able to hold the tax ordinance valid.

INTRASTATE TRANSACTIONS CONDUCTED IN PART OUTSIDE THE TAXING MUNICIPALITY

A city has the same interstate commerce problems in imposing a sales or gross receipts tax as does a state. But the fact that a city's jurisdiction covers only a fraction of the territory embraced within a state raises the additional issue of the extent to which a city may levy an excise on transactions conducted entirely within the state but partly outside the city's boundaries. Because of the small area of a city, intrastate, intercity sales are common.

In order to avoid multiplicity of taxation of businesses within the state, state legislatures generally include in their enabling acts or city charters limitations restricting the local taxing power to businesses conducted or activities taking place within the corporate limits. Such a provision has been construed by the courts to have somewhat, but not precisely, the *verboten* effects of the federal interstate commerce clause. Exceptions to this customary solution of the problem are occasionally found. The Alabama Assembly provided by way of an enabling statute that any city or town could fix and "collect licenses for any business, trade or profession done within the police jurisdiction of such city or town and without the corporate limits thereof . . . "; and "police jurisdiction" was defined to cover "all adjoining territory within three miles of the corporate limits."[16] The enabling act for New York City prohibits taxes "on any transaction originating and/or consummated outside of the territorial limits of any such city, notwithstanding that some act be necessarily performed with respect to such transaction within such limits."[17] But it further states, ". . . provided, however, that nothing herein contained shall limit or prevent the imposition of a tax on gross income or a tax on gross receipts of persons, firms and corporations doing business in any such city."

Despite the broad language of the proviso, the city has not imposed its gross receipts tax on transactions which take place entirely outside the city limits. Thus, if a contracting firm, with its main office in the city, were to build a structure in Albany, and the firm did no work in New York City in connection with that contract, it need not include the receipts from its Albany contract in its tax return. On the other hand, if a manufacturer sells his product to a firm in Albany, the entire proceeds are taxable just as though the transaction were consummated in New York City. This interpretation of the enabling act and of the local tax law has yet to be litigated. Other cities, without such a provision in their enabling act or charter, have also been permitted to levy taxes on the gross receipts of businesses located within the city but engaged in intercity activities.[18]

[16] See White v. City of Decatur, 225 Ala. 646, 144 So. 873 (1932), where defendant's place of business was held to be "in adjoining territory," even though separated by a county line and the Tennessee River.

[17] N. Y. Laws 1934, c. 873, §1.

[18] See City of Sedalia v. Standard Oil Co. of Indiana, 66 F. (2d) 757 (C. C. A. 8th, 1933), *cert. denied*, 290 U. S. 706 (1933), where the city was authorized to include as taxable receipts under a license tax on gasoline sellers the proceeds of gasoline sold within the city but delivered outside; City of Dothan v. Alabama Power Co., 229 Ala. 146, 155 So. 697 (1934), holding that a utility company delivering

An entirely different issue is raised in the case of a sales tax or compensating use tax collectible from consumers. In a typical sales tax transaction, a merchant within the taxing locality sells goods to an out-of-town consumer. The transaction takes place within the taxing jurisdiction and hence is theoretically subject to the impost. But practical considerations dictate the city's policy here. The city cannot afford to alienate shoppers from other communities; and, therefore, when delivery of merchandise is made outside its limits, the transaction is considered tax exempt. On the other hand, to give a blanket exemption to all purchasers on their statement that they reside outside the city would encourage tax evasion by residents of the city. Hence, if delivery is made within the city limits, policy dictates that the transaction should be taxable.[19]

Take the reverse situation of a sale made by an out-of-town vendor to a resident of the taxing municipality, where the vendor has no place of business within the taxing jurisdiction. The use tax in New York City attempts to reach this type of transaction in order to prevent the diversion of business from New York City vendors. A New York City resident who purchases materials in Boston is as liable for the two per cent use tax as he would be for the two per cent sales tax had he made his purchase in New York City. But there is a tremendous difference in the administration of the sales and the use tax.

It is far easier for the city to administer the collection of taxes by using vendors as tax collectors than by trying to collect from each purchaser on each purchase made. While most out-of-town purchases by local business firms are reflected on their books and are therefore subject to audit, purchases by individuals for use or consumption in the home can hardly be traced save through an inept, hit-or-miss system of inspecting train and truck deliveries within the municipality, or through an equally inept and even more disagreeable system of espionage. Because of this, it is desirable to bring as many such transactions as possible within the framework of the sales tax and to require the out-of-town vendor to collect the tax for the city.

The means of thus extending the scope of the sales tax were considerably strengthened when the City of New York in *McGoldrick v. Berwind-White Coal Mining Co.*[20] succeeded in setting aside certain objections based on the interstate commerce clause of the Constitution. The case held that, regardless of the place of formal "acceptance" of an order, and regardless of the place of technical transfer of title by virtue of an "f. o. b." or similar clause in the contract, the state of delivery

within, and only to, one city was "doing business within the city," so as to be subject to an annual license tax, even though the electric energy was generated elsewhere; Bentley-Gray Goods Co. v. City of Tampa, 137 Fla. 641, 188 So. 758 (1939), where a license tax on wholesale merchants, based on gross sales, was held valid when applied to receipts from merchandise delivered outside the city; Bluefield Produce & Provision Co. v. City of Bluefield, 120 W. Va. 111, 196 S. E. 568 (1938), holding that the municipality could include in its tax base, under a license tax on retailers and wholesalers, receipts from all intrastate, but not interstate, sales.

[19] Where fur coats are purchased in New York City by nonresidents, and the purchase contracts call for temporary storage of the coats within the city and for subsequent delivery out-of-town at the expense of the vendors, the transactions are not subject to the sales tax. Matter of Gunther's Sons v. McGoldrick, 279 N. Y. 148, 18 N. E. (2d) 12 (1938).

[20] 309 U. S. 33 (1940).

may require an out-of-state vendor to collect the sales tax on a transaction where the vendor maintained an office within the state of delivery, solicited the order there and shipped the goods there.[21] This ruling was followed a few months later by that of *United Autographic Register Co. v. McGoldrick*,[22] which determined in effect that the enabling act for the city presented no greater obstacles than does the interstate commerce clause to taxing transactions of the *Berwind-White* type. Although the members of both the Court of Appeals and the Appellate Division divided on the issue, the majority in each court rejected the vendor's contention that the transactions for which tax liability was claimed were consummated outside the City of New York and hence fell within the enabling act's proscription on "the imposition of a tax on any transaction originating and/or consummated outside the [city's] territorial limits. . . ."

The ground of decision is, it is true, superficially reminiscent of the *Wiloil* era in the federal-state realm:[23] "The required approval [from the home office] is really automatic as the instances of rejection of any order are very few, indeed no specific instance was adduced at the hearing. The procedure of approval and acknowledgment is really collateral and incidental. The delivery from the particular source selected by the petitioner outside the State is solely a matter of convenience or economy in the petitioner's method of conducting business."[24] Nevertheless, there is little reason to believe that the New York courts intended to tie city power under the enabling act to the now outmoded *Wiloil* dialectic concerning intent and title, leaving power commensurate with the *Berwind-White* philosophy of physical delivery to the vicissitudes of further litigation. That battle will not have to be refought on another front. And of course, what holds for the interpretation of the enabling act in regard to transactions involving shipment across state lines, holds *a fortiori* for transactions involving intrastate shipments across city lines. The vendor who regularly does business with residents of a taxing city will in the future find himself increasingly obligated to act as tax collector for that governmental unit even though he ships his merchandise from other municipalities.

MUNICIPAL TAX ADMINISTRATION

It has been stated of municipal excises: "The local units hold the least desirable position in the total tax system. Limited in area and jurisdictional powers, they cannot well administer sales, gasoline, income, inheritance, and other taxes."[25] But

[21] Extension of the scope of state and municipal sales taxation on the interstate plane is fully discussed by McNamara, *Jurisdictional and Interstate Commerce Problems in Imposition of Excises on Sales*, *supra* this issue. New York City, as a hub of interstate commerce, makes a special effort not to saddle firms which are located outside the city but which do business within it, with burdens that are not borne by all local taxpayers. Thus, where an outside business firm requests that the City Comptroller conduct a tax audit outside the city, the request is generally granted. In such a case the travelling and hotel expenses of the auditors are paid by the taxpayer, but close supervision of such expenses by the tax administrator keeps them to a minimum.

[22] 260 App. Div. 157, 21 N. Y. S. (2d) 129, *aff'd*, by memorandum decision, 32 N. E. (2d) 826 (N. Y. 1941).

[23] Wiloil Corp. v. Pennsylvania, 294 U. S. 169 (1935).

[24] United Automatic Register Co. v. McGoldrick, *supra* note 22, at 161, 21 N. Y. S. (2d) at 132.

[25] Hillhouse, *New Sources of Municipal Revenue* (Municipal Finance Officers' Ass'n of U. S. and Canada, 1935) 2.

even as the small area of a municipality's taxing jurisdiction may work to its economic disadvantage, so does its concentration of taxpayers make the work of administration easier and more economical. Disadvantages in enforcement are few and may be summarized as follows:

Organization of Tax Enforcement Agency

The states have had long experience in collecting excise taxes. Through their tax bureaus, with jurisdiction over corporation franchise, income and other taxes, they find it easy to absorb the administration of new imposts into existing organizations. On the other hand, a city cannot rely upon its real property tax bureau to collect a sales or gross receipts tax. An entirely new mechanism is required to deal with a completely different tax base. To some extent a city may overcome this initial disadvantage by importing experienced directors from other jurisdictions; but local demands, particularly in times of economic stress, generally hold such practice to a minimum.

Compensating Use Tax Administration

The small area of a city makes it inevitable that a larger portion of goods consumed or used within the city should be purchased outside its jurisdiction than is the case with a state. Until such time as a federal sales tax is adopted, it will be impossible for either a state or a city to achieve a high degree of enforcement. While the problem is more serious for a city than a state, its importance will decrease correspondingly as the sales tax is extended to cover intercity and interstate transactions.[26]

Against these disadvantages are several advantages of municipal enforcement.

Registration of Taxpayers

In determining who should register as a taxpayer or who should file a tax return, a municipality can send a squad of investigators through its streets and buildings to list every businessman who is a potential taxpayer. This the states can do too; but the magnitude of the task in covering rural as well as urban areas precludes a thorough search. Not only is there this difference; a city can minimize the cost by utilizing in the registration its policemen, firemen and other employees. New York City, when it first imposed its sales and gross business taxes, turned the task of registration over to its Police Department, a large portion of whose staff of 18,000 men first distributed registration certificates and then inspected business premises to determine compliance with the requirement that the certificate be hung on the wall. The Police Department is still available to make recurrent checks to see that new businesses are registered.

Furthermore, several score types of business are licensed by the city for purposes of regulation. The Police Department, Fire Department, License Department, Department of Housing and Buildings, and other agencies supply the names of such

[26] See pp. 620-621, *supra*.

concerns to the Emergency Revenue Division and will suspend or revoke licenses or permits of firms which violate the tax laws. The states, supplying only a fraction of the services performed by municipalities, have fewer agencies and fewer men to call upon for such assistance.

Auditing Books of Taxpayers

Auditing work is done more expeditiously where little travelling time is required. Taxpayers may be asked to submit their books for examination at the office of the tax agency without much inconvenience to them. With all tax returns coming from one city, even though neighborhoods vary greatly in character, a norm can be set up for each type of business. Examination of returns against the norm provides a good basis for selecting taxpayers to be audited.

Hearings on Tax Audits or on Regulations

With the main office of the tax agency in the same city, a taxpayer finds it considerably less expensive to contest assessments made by the agency's auditors and tax counsel. By the same token, taxpayers who cannot afford to go to the state capitol for hearings on tax regulations, will request the administrative officer in charge to hold a hearing to correct inequities in the rules and regulations of the department. The cooperation between the Comptroller of New York City and business groups in holding such hearings accounts in large measure for the city's record on refunds. During the period October 1, 1934, to December 31, 1940, New York City refunded only $621,000 of some $432,000,000 collected in excise taxes.

For these reasons the cost of administration in New York City compares favorably with the cost incurred by the states which impose similar taxes.[27] As no two states or cities impose precisely the same taxes, one cannot generalize on comparative costs of enforcement; but, once a municipality has achieved a measure of experience in enforcement of excises, it should be able to make its collections more efficiently and at lower costs than can the states.

CONCLUSION

From the point of view of the national economy and the ideal tax system, municipal excise taxes are undeniably bad. If all the 16,000 taxing jurisdictions in the United States[28] were to impose their own excise taxes, the admittedly undesirable situation now existing with regard to interstate trade barriers would be aggravated many times over. But we are faced with the hard fact that it is essential that municipal services, which affect the public to a much greater extent than do those of the state and federal governments, should not be impaired, and should continue to expand in accordance with the higher standards that progress brings to all com-

[27] See JACOBY, RETAIL SALES TAXATION (1938) 291-292. On state collection costs, see Huston and Berryman, *Collection and Enforcement of State Consumption Excise Taxes, supra* this issue. The ratio of administrative costs to collections for New York City for the fiscal year ended June 30, 1939, was 1.69 per cent and for the comparable period in 1938, 1.68 per cent.

[28] Ill. Tax Comm., *Atlas of Taxing Units*, 1 SURVEY OF LOCAL FINANCE (1939).

munities. To deprive the cities of taxing powers without adding commensurately to their revenues is to solve in part the trade barrier issue at the expense of the more vital needs of the public. For example, New York City could not have cared for its needy, nor could the cities of New York State now embark on a low cost housing program, without adequate tax resources. Many municipalities during the past decade, in the absence of such resources, were unable to pay the salaries of employees, and had to close schools and curtail other functions. Faced with the necessity of finding new sources of revenue, New York City at one time considered, as against the imposition of its two per cent sales tax, an increase in the subway fare from five cents to seven cents. Only slight research was needed to show that the burden of a higher subway fare would have a more adverse effect upon the poorest people of the city than would sales taxation.

One solution to the problems both of tariff barriers and of additional revenues for localities would be the extension of excise taxes to state areas or possibly the entire nation, and the allocation of the revenues resulting therefrom to those local governmental units most in need.[29] However, disparity of need for such revenues among different localities and different states stands in the way of such a plan.[30] Some businessmen, who now enjoy the advantages of location in a comparatively tax-free community, would oppose, of course, a uniform tax system that would hit them equally with their competitors. But if the present trend continues, it is only a matter of time before the difficulties of doing interstate or even intercity business become so great that practically all businessmen will favor uniformity. At such time we may expect the legislatures and the Congress to cooperate in putting the excise tax system on a better basis.

The advantages of local administration of taxes need not be lost under a system of state-wide or federal tax levies. With a substantial portion of the tax moneys from each locality being returned for local use, the various municipal agencies could be utilized to tighten collections. Decentralization of hearings on audits is possible with resultant economies to taxpayers, and decentralization of hearings on regulations would enable trade associations to cooperate with government even to the extent of policing transactions in order to have all similarly situated businessmen compete on the same basis. Finally, it should be possible under such a system to work out a series of regulations which could be applied locally to fit peculiar community conditions without disrupting the state-wide or national features of such taxes.

[29] See LaGuardia, *A Uniform System of Taxation*, N. Y. Times, Jan. 12, 1940, reprinted in (1940) 18 TAXES 135; Hellerstein and Hennefeld, *State Taxation in a National Economy* (1941) 54 HARV. L. REV. 949.

[30] On the problems raised by efforts at geographical allocation, see Smart and Hart, *The Distribution of Revenues from State-Collected Consumer Taxes*, *supra* this issue.

FEDERAL EXPERIENCE WITH CONSUMPTION EXCISES

Charles R. Kavanaugh*

It is not surprising, in view of the complexity of the federal income tax laws and the extent of their application, that the excise taxes are completely overshadowed by the income taxes in the minds of many tax students and practitioners. Nevertheless, the tendency on the part of some of them to dismiss excise taxes as temporary expedients is clearly unwarranted. Such taxes, in varying forms, are undoubtedly here to stay and therefore deserve closer attention than is ordinarily accorded them. This is particularly true at the present time, as it may well be that these taxes will be extended to cover an ever widening circle.

Both historically and fiscally, excise taxes have played an important part in the federal tax system. The experience of the Government with these taxes began 150 years ago and falls within three distinct periods—1791 to 1802,[1] 1813 to 1818,[2] and 1862 to the present time.[3] The taxes on liquor and tobacco constituted the backbone of our modern system of taxation at its inception in 1862,[4] and for many years thereafter these taxes continued to be the principal sources of internal revenue.[5] The internal revenue receipts for the first two periods referred to above were $6,758,764.26 and $25,833,449.43, respectively.[6] In contrast to these relatively modest amounts, total tax collections for the fiscal year 1940 were in round figures 5 billion dollars.[7] The excise taxes produced approximately three-fifths of this sum, while the income taxes accounted for the balance.[8]

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Although the writer is employed by the United States Bureau of Internal Revenue, the views expressed herein are entirely his own and nothing herein shall be taken as the official opinion of the Bureau of Internal Revenue.

[1] The taxes of the first period were imposed with respect to carriages, retail dealers in wines and foreign spirituous liquors, snuff, refined sugar, property sold at auction, legal instruments, real estate, and sales. Codification of Internal Revenue Laws (1938) xi.

[2] The subjects of the taxes of the second period were refined sugar, carriages, distillers, sales at auction, distilled spirits, manufactured articles, household furniture, watches, gold, silver, plated ware, jewelry, real estate, and slaves. *Ibid.*

[3] The Act of July 1, 1862, which marked the beginning of the third period, created the office of Commissioner of Internal Revenue and "taxed practically everything which Congress thought was susceptible of yielding revenue." *Ibid.*

[4] *Ibid.*

[5] Even in the fiscal year 1940, liquor and tobacco taxes produced more than one-fifth of the total revenue. Rep. Com'r Int. Rev. (1940) 1, 2.

[6] Codification of Internal Revenue Laws (1938) xi.

[7] Rep. Com'r Int. Rev. (1940) 1, 2.

[8] *Ibid.*

The purpose of this paper is to discuss important phases of the Government's experience with such of the present excise taxes as may be classified as consumption excises. Admittedly, the classification of excise taxes into consumption excises and others is open to the objection that it is somewhat unrealistic, as government officials do not, in the practical work of administering the excise tax laws, think or talk in such terms. Nevertheless, it would seem that taxes which are measured by prices or quantities and paid by consumers or passed on to them may properly be classified as consumption excises.

ADMISSIONS

The several admission taxes,[9] collected[10] from the patrons and paid over[11] to the collector, are component parts of a comprehensive system designed to cover admissions as a whole.[12]

Admissions to Any Place

The admission tax which has the widest application is of course the one[13] with respect to admissions to any place. Strangely enough, the nature of the transactions to which this tax applies would seem to vary with the circumstances. In the usual case where the amount paid exceeds the taxable minimum, the transaction is the act of paying for the admission[14] rather than the exercising of the privilege to enter, for the tax is payable regardless of whether such privilege is ever exercised.[15] In the case of a taxable free or reduced-rate admission,[16] the nature of the transaction to which the tax applies is not spelled out clearly in either the statute or the regulations. If the right to such admission is evidenced by a ticket, the tax is payable upon the issuance of the ticket.[17] This requirement indicates that the taxable transaction is the act of receiving the ticket or, in the case of a reduced-rate admission, probably the payment for the ticket. On the other hand, if the right to such admission is not evidenced by a ticket, the tax is payable upon admittance.[18] The implication of this requirement is that, in the case of a free admission, the transaction is the actual exercise of the privilege to enter the place and that, in the case of a reduced-rate admission, the transaction is either the same as in the other case or is the payment for the admission, the payment of the tax being postponed until actual admittance if the admission payment preceded that event.

The meaning of the term "place," as used in the statute[19] imposing the general admission tax, has been the subject of some controversy. The regulations[20] provide that the basic idea conveyed by this term is that of a definite inclosure or location, and that places of amusement obviously constitute the most important class of

[9] INT. REV. CODE §1700.

[10] *Id.* §1715(a).

[11] *Id.* §1715(b).

[12] Excluded from the present study, because not within the field of consumption excises as defined, are the taxes on sales of tickets at excessive prices.

[13] INT. REV. CODE §1700(a)(1).

[14] U. S. Treas. Reg. 43 (1940) §101.4.

[15] *Ibid.*

[16] See INT. REV. CODE §1700(a)(1).

[17] U. S. Treas. Reg. 43 (1940) §101.5.

[18] *Ibid.*

[19] Cited *supra* note 13.

[20] U. S. Treas. Reg. 43 (1940) §101.3.

"places." It includes, in addition to ordinary places of amusement, a swimming pool,[21] a skating rink,[22] and a private mountain resort,[23] but it does not include a sight-seeing aircraft.[24] Another ground for contesting the application of this tax has been that the charge in question was not for admission but rather for rent, expenses, or other purposes. A charge required for admittance to a swimming pool[25] or skating rink[26] is an admission charge, even though payment entitles the persons to the use of a swimming suit and towels or skates. The same rule applies where a so-called toll charge[27] is collected on a private road leading to a mountain resort, and in the case of a so-called contribution[28] paid for a ticket entitling the "contributor" to a seat at a political mass meeting. But a charge for transporting guests to and from an island on which is maintained a private beach is apparently for transportation expenses and is not an admission charge.[29] Nor is the amount which a student is required to pay, as a student activity fee, for a non-transferable book good for admission to student activities and athletic events.[30] However, if the payment by the student is voluntary, as in the case of student season tickets, it is held to be an amount paid for admission.[31]

This tax, as applicable to admissions to dances, may not be avoided by the expedient of a multiple or combination ticket. In such a case, the admission charge is the total amount paid for the entire ticket.[32] Several questions have also arisen concerning application of the provisions as to taxable free or reduced-rate admissions.[33] The statutory exception as to persons who may be admitted free without payment of tax does not include children over 12 because of the fact they are inmates of charitable institutions, nor members of the Civilian Conservation Corps, nor men in the Army, Navy, or Marine Corps.[34] It has also been urged that where ladies are admitted to a ball game without charge or at reduced rates, no tax should be required, the theory being that the basis on which they are admitted constitutes the established price for the accommodations to which they are restricted. But as their seat accommodations are substantially similar to those in other parts of the stands for which regular admission price is charged and as the privilege is confined to women and limited to one day a week, the Bureau's position is that their admission is taxable under the statute.[35]

The taxability of public admissions to athletic events held by state schools was not definitely settled until recently. The application of the tax to such admissions was vigorously contested on the ground that the tax unconstitutionally burdened the

[21] Twin Falls Natatorium v. U. S., 22 F. (2d) 308 (D. Idaho 1927); S. T. 859, 1937-1 C. B. 334.

[22] U. S. v. Koller *et al.*, 287 Fed. 418 (W. D. Wash. 1921), *appeal dismissed*, 260 U. S. 757 (1922).

[23] Chimney Rock Co. v. U. S., 63 Ct. Cl. 660 (1927), *cert. denied*, 275 U. S. 552 (1927).

[24] S. T. 664, XII-1 C. B. 424 (1932).

[25] Twin Falls Natatorium v. U. S., *supra* note 21.

[26] U. S. v. Koller *et al.*, *supra* note 22.

[27] Chimney Rock Co. v. U. S., *supra* note 23.

[28] S. M. 2853, IV-1 C. B. 294 (1924).

[29] Huguenot Yacht Club v. U. S., 32 F. Supp. 387 (S. D. N. Y. 1940).

[30] S. T. 563, XI-2 C. B. 522 (1931).

[31] *Ibid.*

[32] S. T. 670, XII-1 C. B. 423 (1932).

[33] INT. REV. CODE §1700(a)(1).

[34] S. T. 910, 1940-2 C. B. 315. *Cf.* U. S. Treas. Reg. 43 (1940) §101.5, excepting reporters, photographers, telegraphers, and radio announcers whose special duties are the sole reason for their presence.

[35] S. T. 697, XII-2 C. B. 353 (1932).

states in the exercise of their governmental functions. The Supreme Court set this problem at rest by holding[36] that such admissions are properly taxable, saying that "the conduct of exhibitions for admissions paid by the public is not such a function of state government as to be free from the burden of a non-discriminatory tax laid on all admissions to public exhibitions for which an admission fee is charged." Similarly, admission charges to a swimming pool operated by a city or other municipality are taxable.[37]

Use or Lease of Boxes or Seats

The nature of the transaction embraced by the tax[38] relating to boxes and seats in an opera house or place of amusement is not clear, and apparently there are no rulings or decisions on this point. As the tax applies regardless of whether the box or seat is used or whether any amount was paid therefor,[39] it would seem that the tax is imposed with respect to a person's having the permanent use of or a lease for the use of the accommodation.[40] The major difficulty encountered in administering the law imposing this tax lies in computing the amount of the tax in certain instances. The tax is based not on the amount, if any, actually paid for the box or seat, but on the amount that would be paid, at the established price, for admission to all performances given, not merely those attended, if payments were separately made for each performance.[41] If there is no comparable box for the use of which on single occasions admission charges are made, the tax is computed by determining the amount for which a single box seat in the same part of the house is sold, multiplying that amount by the number of seats in the box, and calculating the tax on the basis above indicated.[42] If there is no box located in a similar position, the tax is computed by determining the amount for which a single seat in the same part of the house is sold, multiplying that amount by the number of seats in the box, and calculating the tax accordingly.[43]

Admissions to Cabarets

The specific transaction to which the cabaret tax[44] applies is not clear. Although, in a broad sense, the transaction contemplated by the statute is the exercise of the privilege to avail oneself of the entertainment, refreshment, and food furnished at the cabaret, it would appear that technically the taxable transaction is the act of paying the amount that includes the admission charge; for both the statute[45] and the regulations[46] provide that the tax applies to the payment of such amount.

Difficulties have been experienced in applying this tax to hotels providing orchestra music and dancing facilities for their patrons in connection with their dining rooms. The regulations[47] state that the entertainment furnished in such a case is a public

[36] Allen v. Regents of the University System of Georgia, 304 U. S. 439 (1938).

[37] S. T. 907, 1940-2 C. B. 316.

[38] INT. REV. CODE §1700(b)(1).

[39] U. S. Treas. Reg. 43 (1940) §101.8.

[40] *Cf.* INT. REV. CODE §§1410, 1520, and 1600.

[41] U. S. Treas. Reg. 43 (1940) §101.8.

[42] *Ibid.*

[43] *Ibid.*

[44] INT. REV. CODE §1700(e)(1).

[45] *Ibid.*

[46] U. S. Treas. Reg. 43 (1940) §101.13.

[47] *Id.* §101.14.

performance for profit and that, if no admission charge for the dance is separately made, the amount paid for refreshments shall be deemed to include the admission charge. In a recent case,[48] the orchestra and dance floor were in one dining room, but patrons of other dining rooms of the hotel were permitted to use the dance floor. There was no cover, minimum, or other special charge. The court held that, though the performance was public, it was not for profit, that no part of the amount paid for refreshments was an admission charge, and that accordingly the hotel was not subject to the tax. The court distinguished the entertainment in this case from entertainment for profit by saying that here it was actually an item of general hotel overhead.

A minimum charge,[49] entitling the patron without further payment to the food and refreshments totaling that amount, is not an amount paid for admission within the meaning of the statute imposing the general admission tax.[50] If the minimum charge is exceeded, it is included as part of the total bill on which the cabaret tax is based.[51] On the other hand, a so-called cover charge is taxable as an amount paid for admission under the general admission statute.[52] If such a charge is inadequate to cover the cost of the entertainment provided, part of the charge for refreshment is deemed to be for admission and subject to the cabaret tax.[53] The determination of the adequacy of the cover charges involves an examination of the daily food and refreshment checks and a comparison of the receipts from cover charges with the cost of the entertainment. This determination is frequently hard to make, particularly where the records of the cabaret proprietor are incomplete. In order to avoid the application of two separate admission taxes in the case of cabarets making cover charges and to eliminate the complications that are often involved in determining the cabaret tax, it would seem that the admission tax laws should be so amended that the general tax would not apply to cover charges and that the cabaret tax would be a fixed percentage applicable to the total cabaret bill.

Exemptions

Admissions for the benefit of certain organizations and persons are exempt from the admission taxes, if the varying conditions specified in the statute[54] are fulfilled. Even though the purposes of an organization, as set forth in its by-laws, are charitable, it will be denied exemption if any of the funds raised through admissions are used for noncharitable activities.[55] Similarly, an organization which engages in educational and non-educational activities is not entitled to exemption as an educational organization.[56] The exemptions as to persons have occasioned some difficulty. Originally it was held that the exemption relating to firemen applied only if the proceeds of the admissions inured to the benefit of the firemen of a city as a class.[57] The present position of the Bureau, however, is that the exemption applies whether the proceeds inure to the benefit of the class or of a single individual.[58] A condition

[48] The Deshler Hotel Co. v. Busey, 36 F. Supp. 392 (S. D. Ohio 1941).
[49] S. T. 799, XIV-1 C. B. 420 (1934).
[50] See INT. REV. CODE §1700(a)(1).
[51] S. T. 799, *supra* note 49.
[52] U. S. Treas. Reg. 43 (1940) §101.13.
[53] *Ibid.*
[54] INT. REV. CODE §1701.
[55] 32 OP. ATT'Y GEN. (1921) 569.
[56] S. T. 885, 1939-2 C. B. 371.
[57] S. M. 2856, IV-1 C. B. 295 (1924).
[58] S. M. 2856A, IV-2 C. B. 251 (1924), revoking S. M. 2856, *supra* note 57.

to the application of the exemption as to agricultural fairs is that no part of the net earnings of the fair shall inure to the benefit of any stockholder of the fair association.[59] Net earnings are those arising from the operation of the fair itself.[60] If the association has stock outstanding upon which dividends may be paid when receipts from the fair warrant such distribution, exemption will be denied.[61] It is immaterial that the fair revenues for a particular year or series of years are devoted exclusively to the improvement of fair property.[62] But if the only earnings distributable are those from sources other than the operation of the fair, the association will not be barred from the exemption.[63] There is no exemption broad enough to cover theatrical performances sponsored by the Works Progress Administration,[64] nor a club organized to continue the associations formed at a citizens' military training camp and to promote the success of the camp in succeeding years.[65] Curiously enough, part of the amount paid for a given lot of admission tickets may be taxable and part nontaxable. Thus where a charitable organization bought tickets from a theater and sold them at a price in excess of the established price plus tax, the amounts paid to the theater were ruled taxable, whereas the excessive charges made by the charitable organization were not.[66]

Evasion and Avoidance

Field audits or investigations have uncovered various methods to evade or avoid the admission taxes, though there seem to be no serious attempts at evasion in the case of the tax relating to boxes or seats in opera houses or places of amusement. A common method of evasion is failure to keep any records or the keeping of false records. Again, the collecting agent may fail to collect or pay over the tax, or, in the case of the general admission tax, he may try to muddy the waters by filing a fraudulent or erroneous claim for exemption. In a few instances resort has been had to collusive contracts in order to obtain the benefits of exemption. A dishonest officer of an exempt organization may enter into such a contract with a promoter, the contract providing that the proceeds of admissions will inure to the organization, but the secret understanding being that part at least of the proceeds will go to the promoter. As there is a minimum taxable admission in connection with the general admission tax, such tax may be avoided altogether by reducing the admission price below that figure. Similarly, a method of evading the cabaret tax involves the proration of the total bill for a party of a number of persons among such persons, in order that the prorated charges will be below the taxable amount.

DUES AND FEES

The taxes[67] relating to dues and fees paid to a social, athletic, or sporting club or organization and life memberships in such a club or organization are paid[68] by the members to the club and paid over[69] by the club to the collector.

[59] INT. REV. CODE §1701(b).
[60] S. T. 417, II-1 C. B. 268 (1922).
[61] *Ibid.*
[62] *Ibid.*
[63] *Ibid.*
[64] S. T. 831, XV-1 C. B. 403 (1935).
[65] S. T. 455, IV-1 C. B. 295 (1924).
[66] S. T. 631, XII-1 C. B. 424 (1932).
[67] INT. REV. CODE §1710(a).
[68] *Id.* §1710(b).
[69] *Id.* §1715(b).

Dues

In view of a recent ruling[70] that the higher rates which went into effect on July 1, 1940, apply to dues payments made on or after that date, regardless of when the period covered by the dues began or ended, the transaction to which the dues tax[71] applies would seem to be the payment of the dues. Broadly speaking, however, this tax is imposed in respect of a person's possession of the right to enjoy the privileges and facilities of the club or organization.

The determination of whether a particular club is a social one within the meaning of the statute presents one of the major problems in the administration of the dues tax statute. The tests[72] which have been worked out administratively are simple; it is the application of them that is difficult. If the social features are a material purpose of the club, it is a social club. On the other hand, if the social features are not a material purpose of the club, but are subordinate and merely incidental to the active furtherance of a different and predominant purpose, such as religion, the arts, education or business, it is not a social club. While the courts have not found fault with these administrative tests, they have experienced similar difficulty in applying them. Recent cases involving the application of these tests are listed in the margin.[73]

A club for the practice or promotion of athletics or sports is an athletic or sporting

[70] S. T. 904, 1940-2 C. B. 320.

[71] INT. REV. CODE §1710(a)(1).

[72] U. S. Treas. Reg. 43 (1940) §101.38.

[73] *Clubs held social:* Duquesne Club v. U. S., 23 F. Supp. 781 (Ct. Cl. 1938), *cert. denied,* 306 U. S. 649 (1939); Denniston v. U. S., 23 F. Supp. 305 (S. D. Ala. 1938); Union Club of Hoboken v. U. S., 22 F. Supp. 416 (Ct. Cl. 1938); Detroit Club v. U. S., 22 F. Supp. 424 (Ct. Cl. 1938); St. Nicholas Club of City of New York v. U. S., 22 F. Supp. 434 (Ct. Cl. 1938); Union Club Co. v. U. S., 21 F. Supp. 412 (Ct. Cl. 1937); Transportation Club of San Francisco v. U. S., 17 F. Supp. 201 (Ct. Cl. 1936); Century Ass'n v. Anderson, 10 F. Supp. 1005 (S. D. N. Y. 1935); Chicago Engineers' Club v. U. S., 9 F. Supp. 680 (Ct. Cl. 1935); Chance v. U. S., 9 F. Supp. 1011 (Ct. Cl. 1935); University Club, City of Washington, D. C. v. U. S., 6 F. Supp. 129 (Ct. Cl. 1934); The Lambs v. U. S., 8 F. Supp. 737 (Ct. Cl. 1934); Sagninaw Club v. U. S., 7 F. Supp. 302 (Ct. Cl. 1934); Town Club of St. Louis v. U. S., 68 F. (2d) 620 (C. C. A. 8th, 1934); Union League Club of Chicago v. U. S., 4 F. Supp. 929 (Ct. Cl. 1933); Wichita Commercial & Social Club Ass'n v. U. S., 2 F. Supp. 476 (Ct. Cl. 1933); Quadrangle Club v. U. S., 64 F. (2d) 80 (C. C. A. 7th, 1933); Quinnipiack Club v. U. S., 4 F. Supp. 996 (Ct. Cl. 1933); Phi Gamma Delta Club v. U. S., 5 F. Supp. 140 (Ct. Cl. 1933); Army and Navy Club of America v. U. S., 53 F. (2d) 277 (Ct. Cl. 1931), *cert. denied,* 285 U. S. 548 (1932); Women's University Club of Seattle v. Poe, 52 F. (2d) 447 (W. D. Wash. 1931); Fleming v. Reinecke, 52 F. (2d) 449 (C. C. A. 7th, 1931), *cert. denied,* 284 U. S. 689 (1932); Women's University Club v. U. S., 50 F. (2d) 469 (Ct. Cl. 1931); Abbott v. U. S., 66 Ct. Cl. 603 (1929), *cert. denied,* 280 U. S. 554 (1920); Fisler v. U. S., 66 Ct. Cl. 220 (1928), *cert. denied,* 279 U. S. 836 (1929); Faculty Club of University of California v. U. S., 65 Ct. Cl. 754 (1928). *Clubs held not social:* Union Club of Pittsburgh v. Heiner, 99 F. (2d) 259 (C. C. A. 3d, 1938) (businessmen's lunches); Krug v. Rasquin, 21 F. Supp. 866 (E. D. N. Y. 1937) (business); Century Club v. U. S., 12 F. Supp. 617 (Ct. Cl. 1935) (business and civic); Squantum Ass'n v. Page, 7 F. Supp. 815 (D. R. I. 1934), *aff'd,* 77 F. (2d) 918 (C. C. A. 1st, 1935) (serving food); Whitehall Lunch Club v. U. S., 9 F. Supp. 132 (Ct. Cl. 1934); Tidwell v. Anderson, 72 F. (2d) 684 (C. C. A. 2d, 1934) (faculty club); Houston Club v. U. S., 58 F. (2d) 487 (Ct. Cl. 1932) (business); Builders' Club of Chicago v. U. S., 58 F. (2d) 503 (Ct. Cl. 1932) (anti-labor union activities); Two-Thirty-Three Club v. Welch, 2 F. Supp. 963 (S. D. Cal. 1932) (civic and philanthropic); The Cordon v. U. S., 46 F. (2d) 719 (Ct. Cl. 1931) (art); Los Angeles City Club v. Welch, 44 F. (2d) 239 (S. D. Cal. 1930) (civic); Cosmos Club v. U. S., 42 F. (2d) 321 (Ct. Cl. 1930) (educational); Washington Club v. U. S., 49 F. (2d) 656 (Ct. Cl. 1930) (educational and cultural); Bankers' Club of America v. U. S., 37 F. (2d) 982 (Ct. Cl. 1930) (meals for businessmen); Aldine Club v. U. S., 65 Ct. Cl. 315 (1928) (businessmen's lunches); City Club of St. Louis v. U. S., 24 F. (2d) 743 (E. D. Mo. 1928) (civic); Chemists' Club v. U. S., 64 Ct. Cl. 156 (1927) (scientific).

club,[74] but the mere possession or use of a gymnasium, swimming pool, or other athletic facilities by a club whose exclusive or predominant purpose is religion or philanthropic social service will not bring it within the taxable class.[75] Although the administrative application of this test has been contested before the courts in several instances,[76] it is considerably easier to apply than the one relating to social clubs. A health club, with elaborate facilities, is probably near the borderline, but it would seem that it might well be classed as an athletic or sporting club.[77]

From the standpoint of tax avoidance, a very important question is that of whether a club can insulate its members from this tax by reorganizing into a corporaton for profit, with the so-called members being relegated to the position of mere privilege holders who have no interest in the club property and no voice in its management. The argument in support of avoidance on this basis is that the dues tax statute was intended to apply only with respect to clubs the members of which have rights in the club property or at least a voice in the management or operation of the facilities. In a recent case,[78] the club was a corporation for profit, with its stock closely held, and the playing members, who were limited in number, had no interest in the club property and took no part in the management of the affairs of the corporation. The contention was that, as the corporation was an organization for profit, it could not be regarded as a social, athletic, or sporting club and that its members were therefore immune from this tax. The court, pointing out the tax-avoidance implications of such a contention, held that the members as a group, rather than the corporation, constituted a sporting club and that their dues were taxable. Apparently, then, the mere fact that the club is organized as, or reorganized into, a corporation will not shield the members from tax; but if, under such circumstances, there is no association or cooperation among the members toward a common objective, they will not be held to constitute such an organization.[79]

Differentiation between taxable dues and nontaxable fees is often extremely difficult. The statute[80] provides that the term "dues" includes assessments, regardless of their purpose, but it sheds no light on the treatment to be accorded special, additional fees or payments. An additional fee that is applicable to each member of a particular class,[81] or that is an incident to membership of a particular class,[82] is taxable. Moreover, even though the fee is not an incident to the membership, if the obligation to pay it continues until notice is given that the special privileges will no longer be used and if the member is subject to expulsion for failure to pay it, as in the case of his regular dues, the fee will be treated as dues.[83] But if the payment of the fee is

[74] U. S. Treas. Reg. 43 (1940) §101.39.

[75] *Ibid.*

[76] *Clubs held athletic or sporting:* Bunker Hill Country Club v. U. S., 9 F. Supp. 52 (Ct. Cl. 1934), *cert. denied*, 296 U. S. 583 (1935); Camp Fire Club of America v. U. S., 1 F. Supp. 782 (Ct. Cl. 1932); Block Hall, Inc. v. U. S., 57 F. (2d) 918 (Ct. Cl. 1932). *Contra:* Arner v. Rogan, 404 C. C. H. ¶9567 (S. D. Cal. 1940).

[77] *Cf.* Arner v. Rogan, *supra* note 76.

[78] Bunker Hill Country Club v. U. S., *supra* note 76.

[79] Arner v. Rogan, *supra* note 76.

[80] INT. REV. CODE §1712(a).

[81] G. C. M. 7507, IX-2 C. B. 414 (1929).

[82] Foran v. McLaughlin, 59 F. (2d) 158 (C. C. A. 9th, 1932).

[83] Hardt v. McLaughlin, 25 F. Supp. 684 (E. D. Pa. 1936); Merion Cricket Club v. U. S., 404 C. C. H. ¶9207 (E. D. Pa. 1940).

optional,[84] or if the so-called assessment is actually voluntary,[85] the amount is not taxable.

Initiation Fees

The tax[86] relating to initiation fees has been held to be an excise tax on the enjoyment of a privilege.[87] Prior to an amendatory[88] definition of the term "initiation fees," this tax was being avoided[89] by requiring new members to purchase a share of stock or a bond in lieu of an ordinary initiation fee.[90] The amendment provides that such fees include any payment, contribution or loan required as a condition precedent to membership, whether or not evidenced by a certificate of interest or indebtedness or share of stock, and irrespective of the person or organization to whom paid, contributed or loaned. It is immaterial that the stock[91] or certificate[92] of membership is purchased from a retiring member by the new member and that the payment is made to the retiring member rather than to the club itself. Moreover, the payment of the fee need not be a condition precedent to membership of all classes;[93] it is enough if it is required for one particular class.[94] The constitutionality of this tax has been contested and upheld.[95]

Life Memberships

The tax[96] on life memberships has been variously described as a tax on the privilege[97] to share in the club facilities or on the enjoyment[98] of a privilege. Inasmuch as this tax applies whether or not the membership privileges are ever exercised,[99] it would be more precise to say that the tax is imposed simply with respect to a person's having a life membership.[100] Resignation or transfer of membership, without more, is not sufficient to cut off further tax liability. It will continue until the club accepts the resignation or recognizes the transfer.[101] As may be supposed, the application of this tax to life memberships acquired before the effective date of

[84] White v. Winchester Country Club, 117 F. (2d) 146 (C. C. A. 1st, 1941); Williamson v. U. S., 12 F. Supp. 26 (W. D. N. C. 1934); Baltimore Country Club v. U. S., 7 F. Supp. 607 (D. Md. 1934); Weld v. Nichols, 9 F. (2d) 977 (D. Mass. 1925).

[85] Pendennis Club v. U. S., 20 F. Supp. 758 (W. D. Ky. 1937); Fresh Meadow Country Club v. U. S., 17 F. Supp. 400 (E. D. N. Y. 1936); Garden City Golf Club v. Corwin, 62 F. (2d) 246 (C. C. A. 2d, 1932).

[86] INT. REV. CODE §1710(a)(2).

[87] Wing Lodge v. Blacklidge, 59 F. (2d) 421 (C. C. A. 7th, 1932); Munn v. Bowers, 47 F. (2d) 204 (C. C. A. 2d, 1931), *cert. denied*, 283 U. S. 845 (1931). *Cf.* S. T. 904, *supra* note 70.

[88] Revenue Act of 1928, §413(a).

[89] H. R. REP. No. 2, 70th Cong., 1st Sess. (1928) 26.

[90] See Masonic Country Club of Western Michigan v. Holden, 18 F. (2d) 553 (C. C. A. 6th, 1927); Derby v. U. S., 17 F. (2d) 119 (Mass. 1927); Alliance Country Club v. U. S., 62 Ct. Cl. 579 (1926); Luken v. U. S., 62 Ct. Cl. 598 (1926); Page v. U. S., 62 Ct. Cl. 590 (1926).

[91] Wing Lodge v. Blacklidge, Munn v. Bowers, both *supra* note 87.

[92] Knollwood Club v. U. S., 74 Ct. Cl. 1 (1931).

[93] S. T. 387, I-2 C. B. 291 (1921).

[94] *Ibid.*

[95] Wing Lodge v. Blacklidge, Munn v. Bowers, both *supra* note 87.

[96] INT. REV. CODE §1710(a)(3).

[97] Multnomah Athletic Club v. Huntley, 47 F. (2d) 352 (D. Ore. 1930).

[98] MacLaughlin v. Williams, 52 F. (2d) 724 (C. C. A. 3d, 1931), *cert. denied*, 284 U. S. 681 (1932). See also McCaughn v. Williams, 23 F. (2d) 840 (C. C. A. 3d, 1928), *cert. denied*, 276 U. S. 629 (1928).

[99] Multnomah Athletic Club v. Huntley, *supra* note 97.

[100] *Cf.* INT. REV. CODE §§1410, 1520, 1600.

[101] S. T. 684, XII-1 C. B. 454 (1932).

the statute has been contested on the grounds that the tax is a direct tax or is retroactive. In view of the nature of the thing taxed, there is no basis for either of these contentions.[102]

PLAYING CARDS AND SAFE DEPOSIT BOXES

The administration of the statute imposing the tax[103] on playing cards does not appear to be attended by any special difficulties. Nevertheless, as any person who offers or exposes for sale playing cards to which revenue stamps are not affixed is classed[104] as a manufacturer and is accordingly under the duty to affix stamps thereto upon sale, it is quite likely that there is some evasion of the tax, either through ignorance or otherwise, particularly on the part of clubs and similar organizations which repurchase and resell decks of cards. There seems to be no evidence that the Bureau encounters any difficulty in the administration of the statute[105] which imposes the tax with respect to safe deposit boxes.

TOBACCO, SNUFF, CIGARS, AND CIGARETTES

The taxes[106] with respect to manufactured tobacco products date back, through an unbroken period, to 1862.[107] As the formative stage of these taxes has thus long since been passed and as administrative officials and industry members, by virtue of almost eighty years' experience, are thoroughly familiar with the requirements of the law, present-day administration in this field is attended by a minimum of difficulties. Despite the implications of the tax-imposing provisions[108] that (in the case of domestic products, for example) the tax is on the manufacture and sale or removal or on the sale or removal alone, it has been established[109] that the taxable transaction is the manufacture or importation. Sale or removal from the factory or customs house simply fixes the time for tax payment. This postponement of payment, it has been said,[110] is designed to mitigate the burden on the manufacturer or importer. A consequence of the nature of the taxable transaction is that tobacco products sold by a manufacturer to a state are taxable; for in such a case the effects of the tax are incidental, indirect, and permissible.[111] The stamps used in connection with the payment of the tobacco taxes are not mere receipts evidencing prior payment of the tax; they are actually the means, through affixation, of tax payment.[112]

The tobacco statute is unique among revenue measures in that it provides[113] that no package of a manufactured product shall contain or have attached thereto any paper, certificate, lottery ticket, or indecent or immoral picture. The validity of the

[102] Multnomah Athletic Club v. Huntley, *supra* note 97; MacLaughlin v. Williams, McCaughn v. Williams, both *supra* note 98.

[103] INT. REV. CODE §§1800, 1807.

[104] *Id.* §1831(a).

[105] *Id.* c. 12.

[106] *Id.* §2000.

[107] Act of July 1, 1862. The tax in respect of cigarette papers and tubes imposed by INT. REV. CODE §2000(d) was not, however, enacted until 1917. Revenue Act of 1917, §404.

[108] See INT. REV. CODE §2000(a)(c)(d).

[109] Liggett & Myers Tobacco Co. v. U. S., 299 U. S. 383 (1937).

[110] *Ibid.*

[111] *Ibid.*

[112] American Tobacco Co. v. U. S., 166 U. S. 468, 476, 477 (1897).

[113] INT. REV. CODE §§2100(d), 2111(c).

forerunner of this provision was vigorously assailed on the ground that, as the coupons involved in that case[114] were of an inappreciable weight and therefore did not interfere in any way with the determination of the tax base,[115] Congress had no authority to prohibit their enclosure. The Court, however, held otherwise, saying that Congress had full power to prescribe that a package required to bear a revenue stamp shall contain only the taxable article.

OLEOMARGARINE

A purpose of the oleomargarine taxes,[116] which can scarcely be characterized as secondary, is to discourage, by heavier taxation,[117] the manufacture of colored oleomargarine[118] in order to reduce the opportunities for its fraudulent distribution to the public as butter and also to assure, by the branding requirements,[119] that taxpaid oleomargarine cannot readily be sold as butter. Available evidence indicates that this purpose has been substantially achieved. While this statement does not mean that the production of colored oleomargarine has been suppressed,[120] it is true that the trade is principally confined to uncolored oleomargarine.[121] The tax[122] on that product is so low that it probably has not retarded or adversely affected the trade. The Supreme Court, early upholding the constitutionality of these taxes,[123] declared that if a tax is within the lawful power of Congress, the exercise of that power may not be judicially restrained because of the results to arise therefrom, and that it would not inquire into the motive or purpose of Congress in enacting these taxes.[124] Although classification problems have arisen in the past,[125] it would appear that recent amendments[126] have largely removed the grounds for such controversies. On the other hand, problems frequently arise under the provision[127] denominating as a manufacturer any person who adds to or mixes with oleomargarine a substance that gives it a yellow color and supplies it to others. In some instances, as where the person is the proprietor of a boarding house, it is clear that the violations occur through ignorance, but in others it is equally clear that the offender had full knowledge of the requirements of the law.[128]

[114] Felsenheld v. U. S., 186 U. S. 126 (1902).

[115] The tax base is quantitative. See INT. REV. CODE §2000.

[116] INT. REV. CODE §§2301(a)(1), 2306.

[117] *Id.* §2301(a)(1).

[118] For definition of colored oleomargarine, see *id.* §2301(a)(2).

[119] *Id.* §§2302(b)(2)(3), 2304(b), 2306; and also U. S. Treas. Reg. No. 9 (1936) arts. 29, 54, and 80.

[120] During the fiscal year 1940, 1,859,931 pounds of colored oleomargarine were produced. REP. COM'R INT. REV. (1940) 26.

[121] The production of uncolored oleomargarine for the fiscal year 1940 amounted to 301,857,570 pounds. *Ibid.*

[122] INT. REV. CODE §2301(a)(1).

[123] McCray v. U. S., 195 U. S. 27 (1904).

[124] *Id.* at 59.

[125] *Product taxable:* National Foods v. U. S., 13 F. Supp. 364 (Ct. Cl. 1936), *cert. denied*, 299 U. S. 544 (1936); Harrow-Taylor Butter Co. v. Crooks, 41 F. (2d) 627 (C. C. A. 8th, 1930); John F. Jelke Co. v. U. S., 63 Ct. Cl. 370 (1927); Wm. J. Moxley v. Hertz, 216 U. S. 344 (1910); Cliff v. U. S., 195 U. S. 159 (1904). *Product not taxable:* Miller v. Standard Nut Margarine Co., 284 U. S. 498 (1932); Foley v. Miller, 24 F. (2d) 722 (S. D. Ohio 1928); Higgins Manufacturing Co. v. Page, 297 Fed. 644 (D. R. I. 1924); Braun & Fitts v. Coyne, 125 Fed. 331 (N. D. Ill. 1899).

[126] Act of July 10, 1930, §1, 46 STAT. 1022 (definition of oleomargarine), and Act of Mar. 4, 1931, §2, 46 STAT. 1549 (determination of yellowness). These amendments are found in INT. REV. CODE §§2300 and 2301(a)(2), respectively.

[127] INT. REV. CODE §2302(a).

[128] Discussion of the closely related taxes on adulterated butter, process or renovated butter, filled cheese

NARCOTICS

The administration of the narcotic laws,[129] from the standpoint of their enforcement, is vested in the Bureau of Narcotics, while the Bureau of Internal Revenue is concerned primarily with tax collections, adjustments, and compromises. Enforcement problems encountered by the Bureau of Narcotics are outside the scope of this paper.

The narcotic taxes apply to narcotic drugs,[130] smoking opium,[131] and marihuana.[132] Although the statutes imposing these taxes are regulatory in purpose and effect, the yield[133] from the tax on narcotic drugs is quite considerable, as such drugs are extensively used in the field of medicine. On the other hand, the requirements[134] of the smoking-opium statute are such that apparently no one has ever qualified as a manufacturer thereunder, and the collections[135] under the marihuana tax are so insignificant as to indicate that lawful traffic in marihuana is very restricted.

Subject to certain exceptions, narcotic drugs may be transferred only in pursuance of a written order from the transferee, prepared on a form furnished by the Government.[136] The exceptions include registered physicians[137] dispensing such drugs to their patients in the course of their professional practice, and dealers[138] transferring such drugs to consumers under prescriptions issued by registered physicians. Moreover, the forms for such orders may be issued only to persons who have registered and paid tax under the occupational tax statute.[139] The validity of the order requirements has been upheld by the Supreme Court in two famous cases.[140] These requirements tend to keep the traffic aboveboard, subject to inspection by Government agents, and to diminish the opportunity of unauthorized persons to obtain the drugs and sell them clandestinely without paying the tax.[141] Thus, there was no basis for the contention that such requirements had nothing to do with facilitating the collection of revenue.[142] Furthermore, as the legislation had some reasonable relation to the exercise of the taxing power, the supposed motives which induced it were not grounds for its invalidation.[143]

The requirement[144] in the smoking-opium statute that the manufacturer must

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and mixed flour is omitted in the interest of space. The taxes on coconut and other vegetable oils are omitted as not falling within the definable limits of consumption taxation. See Studenski, *Characteristics, Developments and Present Status of Consumption Taxes*, *supra* this issue, for an attempt to define the field. So also of the taxes on firearms. *Cf.* discussion of bituminous coal taxes, *infra*.

[129] INT. REV. CODE c. 23.

[130] *Id.* §2550(a).

[131] *Id.* §2567(a).

[132] *Id.* §2590(a).

[133] Collections, including occupational taxes, for the fiscal year 1940 were $605,395.66. REP. COM'R INT. REV. (1940) 25.

[134] INT. REV. CODE §§2567(a), 2569(b)(c)(d).

[135] Collections, including occupational taxes, for the fiscal year 1940 were $4,702.60. REP. COM'R INT. REV. (1940) 25.

[136] INT. REV. CODE §2554. *Cf. id.* §2591, requiring orders for transfers of marihuana.

[137] *Id.* §2554(c)(1).

[138] *Id.* §2554(c)(2).

[139] *Id.* §2554(f).

[140] U. S. v. Doremus, 249 U. S. 86 (1919); Nigro v. U. S., 276 U. S. 332 (1928).

[141] See U. S. v. Doremus, *supra* note 140.

[142] *Ibid.*

[143] *Ibid.*

[144] INT. REV. CODE §2569(c).

be a citizen has been upheld.[145] The Constitution does not require Congress to extend such privilege to a noncitizen.[146] Another case[147] under this statute is an object lesson for all taxing authorities. Regulations implementing the general requirements of a destructive tax measure are as necessary as similar regulations under a statute designed solely for revenue purposes. Unless such requirements are so implemented, there is no way that compliance may be had with them and consequently they may be disregarded with impunity.[148]

WHITE PHOSPHORUS MATCHES

The original purpose of the statute[149] with respect to white phosphorus matches, which was to suppress the production of poisonous matches, has long since been completely accomplished, as there have been no manufacturers of these matches and no collections under this statute for many years. The use of white phosphorus in the manufacture of matches caused necrosis, or "phossy jaw," a painful and disfiguring disease, while the matches themselves were efficient instruments of self-destruction and a constant menace to children. The humanitarian action by the company which controlled the use of a harmless substitute, in surrendering its letters patent to the Government, now enables all manufacturers to use this compound without payment of royalties.

LIQUOR

Although the liquor taxes[150] produce well over one-half billion dollars per year,[151] the provisions imposing such taxes are at the same time highly regulatory, both in purpose and effect. But, here, regulation is resorted to primarily as a true incident of the taxing power rather than to accomplish a nonrevenue purpose; that is, the regulation is designed to protect the revenue and to facilitate its collection. Nevertheless, in view of the great extent to which the liquor industry is subjected to rigid, detailed statutory provisions and voluminous regulations, and the litigious disposition of many a businessman chafing under governmental regulation regardless of its purpose, it might be supposed that the administration of the liquor laws is accompanied by a ceaseless flow of administrative rulings and by interminable litigation. The remarkable fact, however, is that the lawful or qualified industry members, almost without exception, follow the letter of the law and the exceedingly detailed regulations down to the last bitter period. The explanation of this phenomenon would seem to be more involved than in the case of the tobacco taxes. Undoubtedly it is due in part to the fact that the taxpayers, through many years of experience, are thoroughly familiar with the requirements of the law and regulations. It is probably due mainly, however, to a feeling on their part that they are on probation and that

[145] Lee Mow Lin v. U. S., 250 Fed. 695 (C. C. A. 8th, 1918), *cert. denied*, 247 U. S. 518 (1918).
[146] *Ibid.*
[147] Chin Sing v. U. S., 227 Fed. 397 (C. C. A. 7th, 1915).
[148] *Ibid.* [149] INT. REV. CODE c. 24. [150] *Id.* §§2800, 3030, 3150.
[151] Collections for the fiscal year 1940, including occupational taxes, were $624,253,156.11. REP. COM'R INT. REV. (1940) 1, 2.

it is definitely to their interests to meet all demands of the Government without protest or resistance.

The major problem in this field is an enforcement problem having to do with illicit producers of distilled spirits. These persons, who carry on their operations entirely outside the law, fall into two principal classes—"moonshiners" in remote, mountainous regions, and remnants of the Prohibition-era gangs in the larger cities. The serious proportions of this problem are clearly indicated by statistics as to seizures and arrests.[152] Nevertheless, the Government is making definite headway in its effort to suppress the illicit production of distilled spirits. Compared with the fiscal year 1939, still seizures decreased 11.6 per cent, mash seizures 19.8 per cent, and arrests 11.1 per cent in 1940.[153] Enforcement progress is further evidenced by mash seizures during the past five years, which decreased 67 per cent.[154] A very effective weapon is afforded the Government by the provision[155] requiring dealers in raw materials for the production of distilled spirits to furnish the Government with the names and addresses of persons to whom such materials are distributed. In the fiscal year 1940, information furnished by such dealers led to the seizure of more than 500 illicit distilleries and 150 vehicles, and to more than 700 arrests.[156]

MANUFACTURERS' EXCISES

The manufacturers' excise taxes[157] are imposed upon various classes of articles[158] sold by the manufacturer, producer, or importer, or, in the case of electrical energy, by the vendor. Moreover, these taxes apply, by reason of sections other than the tax-imposing provisions, to leases[159] of such articles and to the use[160] thereof by manufacturers, producers, or importers. The language of the tax-imposing provisions has in the past occasioned some uncertainty as to the precise nature of the taxable transaction. An early interpretation[161] was that such transaction was the manufacture of the article. A later contention[162] had it that the transaction consisted in the manufacture (or production or importation) and the sale of the article. The present view,[163] resulting from a decision[164] of the Supreme Court, is that where a sale, for example, is involved, the transaction is simply the sale. The payment of these taxes is required to be made by the manufacturer, producer, or importer, or, in the case of electrical energy, by the vendor.[165]

[152] During the fiscal year 1940, investigators seized 10,663 stills, with an aggregate mash capacity of 1,653,775 gallons; 6,480,240 gallons of mash; 264,594 gallons of spirits; and 4,523 automobiles and trucks. This property totaled an aggregate appraised value of over $2,000,000 dollars. In the same period, 25,638 persons were arrested. *Id.* at 34.

[153] *Ibid.*

[154] *Ibid.*

[155] INT. REV. CODE §2811.

[156] REP. COM'R INT. REV. (1940) 34.

[157] INT. REV. CODE c. 29-A. The sugar tax, while levied on manufacture rather than sale, is treated for most purposes as a manufacturers' excise. The principal difference arises with respect to sales to governmental bodies. See note 271, *infra*.

[158] These articles are specified in *id.* §§3400-3413.

[159] *Id.* §3440.

[160] *Id.* §3444.

[161] 31 OP. ATT'Y GEN. (1919) 520.

[162] Indian Motorcycle Co. v. U. S., 283 U. S. 570, 574 (1931).

[163] U. S. Treas. Reg. 46 (1940) §§316.30, 316.40, 316.50, 316.70, 316.80.

[164] Indian Motorcycle Co. v. U. S., *supra* note 162.

[165] See U. S. Treas. Reg. 46 (1940) §316.3; *id.* 44 (1939) §314.3; *id.* 42 (1932) art. 41, c. v, as amended by T. D. 4393.

Tires and Inner Tubes

The tax[166] relating to tires and inner tubes is measured by the weight of the article. Although this weight basis operates fairly in most instances, its application to tires for children's vehicles such as wagons and scooters is somewhat inequitable. In the case of such tires the tax may well equal nearly one-half their cost, whereas the tax on automobile tires is obviously a much smaller percentage of their cost. As this tax applies to tires for any vehicle,[167] all tires are taxable unless the thing on which they are mounted is incapable of use as a means of transporting a person or burden.[168]

A question that has caused some difficulty in connection with the administration of the statute imposing this tax is whether retreaded tires are subject to taxation. Formerly, the Bureau's position[169] with respect to this matter was that if the retreading operation destroyed the original identity of the tire, the process was manufacturing or production and the tire was taxable.[170] Recently, however, the Bureau has abandoned this position in favor of another test developed judicially[171] in respect of automobile parts produced from junk material. Under the new test, if a person produces a tire from scrap, salvage, or junk material by processing, manipulating, or changing the form of the article or by combining or assembling two or more articles, he is a manufacturer and the tire so produced is taxable.[172] Another question arising under the statute imposing this tax is whether a mileage contract is a lease.[173] Under such a contract the tire manufacturer supplying the tires retains title thereto and agrees to service them during the term of the contract, while the bus company agrees to pay for the use of the tires at a specified rate per mile and to purchase them at the end of the contract at the list price, less the mileage amount theretofore paid under the contract. Such a contract has been ruled to be a lease for the purposes of this tax and the tires furnished thereunder declared taxable,[174] the tax liability being incurred upon the delivery of the tires.[175]

Toilet Preparations

One of the chief difficulties in connection with administering the statute imposing the tax[176] on toilet preparations has been the determination, in special instances, of who is the manufacturer. If *M* Company arranges to have a product manufactured by *X* Company according to its specification and for sale under its name,[177] or if it furnishes ingredients for a product to be manufactured for it by *Y* Company,[178]

[166] INT. REV. CODE §3400.

[167] S. T. 660, XII-1 C. B. 385 (1932). *Cf.* S. T. 465, XI-2 C. B. 454 (1931).

[168] *Ibid.*

[169] S. T. 812, XIV-1 C. B. 406 (1934); S. T. 648, XII-1 C. B. 384 (1932).

[170] *Cf.* Skinner v. U. S., 8 F. Supp. 999 (S. D. Ohio 1934). Although the court in this case employed broad language to the effect that the tax is limited to new tires, the actual decision was not inconsistent with the Bureau's earliest test, as the original identity of the tires there involved had not in fact been destroyed.

[171] Clawson & Balls v. Harrison, 108 F. (2d) 991 (C. C. A. 7th, 1939).

[172] U. S. Treas. Reg. 46 (1940) §316.4. See also S. T. 896, 1940-1 C. B. 252.

[173] See INT. REV. CODE §3440.

[174] G. C. M. 11410, XII-1 C. B. 382 (1932); S. T. 496, XI-2 C. B. 455 (1931).

[175] S. T. 496, *supra* note 174.

[176] INT. REV. CODE §3401.

[177] G. C. M. 16223, XV-1 C. B. 380 (1935).

[178] G. C. M. 11522, XII-1 C. B. 387 (1932).

M Company is deemed to be the manufacturer of the product. On the other hand, if *N* Company buys a product from *A* Company and packages it itself under its trade name,[179] or if it buys a product manufactured and packed for it by *B* Company,[180] or if it merely furnishes the containers for a product to be manufactured for it by *C* Company,[181] *N* Company is held not to be the manufacturer of the product. A druggist may treat as exempt from this tax a preparation compounded by him pursuant to a prescription, as it is assumed that a *bona fide* prescription is written for medical purposes.[182] But where the physician specifies on the prescription that the preparation is for toilet purposes, the druggist is regarded as the manufacturer.[183] Beauty shops and barber shops are permitted to add water to a taxpaid toilet preparation without incurring liability as a manufacturer, if such addition is made as part of the business of rendering personal service to their patrons.[184] However, if the addition of water is in any such case done for the purpose of preparing the article for sale rather than use in business, the shop is held to be a manufacturer.[185]

This tax, being applicable solely to sales made by manufacturers, producers, or importers, operates with discriminatory effects that probably were not within the contemplation of Congress. A manufacturer who produces and sells products in bulk naturally makes his sales on a much lower price level than does a manufacturer producing and packaging his product. As this tax is based on price rather than quantity, the first manufacturer bears a much lighter tax burden than the second. It scarcely needs to be pointed out that certain manufacturers have taken advantage of this situation to minimize their taxes. In order to safeguard the revenue and to obviate the inequity under consideration, it might well be advisable to extend this tax to persons who package toilet preparations in the form in which they are sold to consumers, whether or not such persons are the actual producers.

The statute provides that the price of toilet peparations shall include, among other items, any charge for coverings and containers, if furnished by the actual manufacturer.[186] Questions have arisen as to whether certain special containers of cosmetics, such as cigarette and vanity cases, are taxable. Formerly, the test used by the Bureau in these cases was the comparative value of the cosmetics and the container.[187] The present test, however, is that of the dominant or primary purpose of the container.[188] Under this test, if the container, no matter how valuable, serves no useful purpose other than as a covering, the charge therefor is includible in the tax basis.

As may be supposed, the Bureau has frequently encountered problems involving the classification of products for the purposes of this tax. It has been ruled that taxable products include preparations to cover birth marks,[189] baby powder,[190]

179 Williams v. Harrison, 110 F. (2d) 989 (C. C. A. 7th, 1940).

180 Charles Marchand Co. v. Higgins, 36 F. Supp. 792 (S. D. N. Y. 1940). See also G. C. M. 11522, *supra* note 178.

181 G. C. M. 11522, *supra* note 178.

182 S. T. 478, XI-2 C. B. 456 (1931).

183 *Ibid.*

184 S. T. 825, XV-1 C. B. 382 (1935).

185 *Ibid.*

186 INT. REV. CODE §3401.

187 S. T. 559, XI-2 C. B. 459 (1931).

188 S. T. 815, XIV-2 C. B. 365 (1934).

189 G. C. M. 10960, XI-2 C. B. 458 (1931).

190 S. T. 693, XII-2 C. B. 312 (1932).

hydrogen peroxide,[191] permanent-waving solutions,[192] and cocoa butter.[193] On the other hand, this tax has been held not to apply to a germicidal solution[194] or to styptic pencils.[195] If an article may be used both for medicinal and toilet purposes, it is taxable, irrespective of its chief use.[196]

Parts and Accessories, Automobile and Truck Bodies, etc.

The tax[197] with respect to parts and accessories has given rise to considerable litigation and numerous administrative rulings. The principal difficulties have to do with the question whether a person who produces parts from scrap, salvage, or junk material is a manufacturer and with the classification of articles as taxable or non-taxable. The earlier test[198] with regard to the first problem was whether the processing operations destroyed the original identity of the article. That test was superseded in 1940 by an entirely different test[199] based on a 1939 decision[200] of the circuit court of appeals for the Seventh Circuit. The position of the Bureau at present in regard to this problem is that if a person produces a part from scrap, salvage, or junk material by processing, manipulating, or changing the form of an article or by combining or assembling two or more articles, he is a manufacturer and the article so produced is taxable. Nevertheless, there are indications that the foundation of the new test is as yet none too secure, for on at least two occasions district courts have refused to follow it.[201]

The task of delimiting the field of taxable parts and accessories by the case-by-case method was considerably facilitated by the provision[202] in the Revenue Act of 1932 that spark plugs, storage batteries,[203] leaf springs, coils,[204] timers,[205] and tire chains,[206] suitable for use on automobiles, trucks, taxable tractors, or motorcycles, are to be considered parts or accessories. The extent to which the case-by-case method has been used and the results obtained are indicated by the partial list of recent decisions and rulings set forth in the margin.[207] While the boundaries of this area

[191] Peroxide Chemical Co. v. Sheehan, 108 F. (2d) 306 (C. C. A. 8th, 1939).

[192] Duradene Co. v. Magruder, 21 F. Supp. 426 (Md. 1937), *aff'd*, 95 F. (2d) 999 (C. C. A. 4th, 1938); S. T. 818, XIV-2 C. B. 366 (1934). [193] S. T. 506, XI-2 C. B. 457 (1931).

[194] Sharp & Dohme v. Ladner, 82 F. (2d) 733 (C. C. A. 3d, 1936).

[195] S. T. 497, XI-2 C. B. 457 (1931).

[196] S. T. 655, XII-1 C. B. 390 (1932). [197] INT. REV. CODE §3403(c).

[198] S. T. 648, XII-1 C. B. 384 (1932); S. T. 812, XIV-1 C. B. 406 (1934).

[199] U. S. Treas. Reg. 46 (1940) §316.4. See also S. T. 896, 1940-1 C. B. 252.

[200] Clawson & Balls v. Harrison, *supra* note 171. *Accord:* U. S. v. Armature Exchange, 116 F. (2d) 969 (C. C. A. 9th, 1941).

[201] Moroley Bearing Service of Oakland, Ltd. v. U. S., 404 C. C. H. ¶9619 (N. D. Cal. 1940); J. Leslie Morris Co. v. U. S., 404 C. C. H. ¶9608 (S. D. Cal. 1940).

[202] Revenue Act of 1932, §606(c), now INT. REV. CODE §3403(c). The Revenue Acts of 1918, §900(3), 1921, §900(3), and 1924, §600(3), contained no such provision.

[203] *Cf.* United States Light & Heat Corp. v. U. S., 3 F. Supp. 861 (Ct. Cl. 1933), *cert. denied*, 291 U. S. 671 (1934).

[204] *Cf.* Atwater Kent Mfg. Co. v. U. S., 62 Ct. Cl. 419 (1926).

[205] *Cf.* Advance Automobile Accessories Corp. v. U. S., 42 F. (2d) 595 (Ct. Cl. 1930); Berg Brothers Mfg. Co. v. U. S., 67 Ct. Cl. 165 (1929); Atwater Kent Mfg. Co. v. U. S., *supra* note 204.

[206] *Cf.* American Chain Co. v. Hartford-Connecticut Fruit Co., 86 F. (2d) 105 (C. C. A. 2d, 1936).

[207] *Held taxable as parts or accessories:* Rochester Woven Belting Corp. v. U. S., 43 F. (2d) 264 (Ct. Cl. 1930) (transmission lining); Walker Mfg. Co. v. U. S., 65 Ct. Cl. 394 (1928) (jacks); Hinsdale Mfg.

have thus been partly marked out, classification controversies will probably continue for some time, though in diminishing volume.

In sharp contrast to the situation involving parts and accessories, the taxes[208] on motorcycles and on automobile and truck bodies and chassis occasion few difficulties. The term "manufacturer" does not include an automobile dealer who makes changes in an automobile at the request of the purchaser, if such changes do not affect the car's use.[209] A hearse chassis[210] is classified as a truck chassis, but fire trucks[211] are not within the purview of this tax. It has also been ruled[212] that a tank for a tank truck should be classified as a truck body. So-called "drive-away" sales have raised a question as to exportation. If an automobile or truck, delivered at the factory, is driven to Canada or Mexico or to a port for loading aboard ship and is not used for any other purpose on such trip, and if the time intervening between the delivery and arrival at the border or port of export is devoted to reaching that point, the vehicle will be considered as having been exported in due course and therefore as not taxable.[213]

Co. v. U. S., 43 F. (2d) 263 (Ct. Cl. 1930) (socket wrenches); Fairmont Tool & Forging Co. v. U. S., 42 F. (2d) 591 (Ct. Cl. 1930) (tool kits); S. T. 643, XII-1 C. B. 397 (1930) (auto radios); Bassick Mfg. Co. v. U. S., 44 F. (2d) 278 (Ct. Cl. 1930) (grease guns); S. T. 739, XIII-1 C. B. 378 (1933) (floor mats); United States Gear Corp. v. U. S., 15 F. Supp. 66 (Ct. Cl. 1936) (differential, pinion, ring, and transmission gears); Brown Sheet Iron & Steel Co. v. Willcuts, 45 F. (2d) 390 (C. C. A. 8th, 1930), *aff'g* 34 F. (2d) 969 (D. Minn. 1929) (steel tanks for use on trucks); S. T. 441, III-1 C. B. 461 (1923) (hoists for trucks); E. Edeleman & Co. v. U. S., 68 Ct. Cl. 168 (1929) (clocks and window antirattlers); Autoquip Mfg. Co. v. U. S., 68 Ct. Cl. 362 (1929) (hand pump and antirattlers); Weir v. McGrath, 52 F. (2d) 201 (S. D. Ohio 1928) (carburetors); Imperial Brass Mfg. Co. v. U. S., 69 Ct. Cl. 20 (1929) (carburetor controls, primers, gasoline strainers, and air pumps); Eskstrom v. U. S., 21 F. Supp. 338 (Ct. Cl. 1937) (universal joints); S. T. 824, XIV-2 C. B. 368 (1934) (various articles cut from lengths or rolls of material and held in stock for sale); S. T. 573, XI-2 C. B. 473 (1931) (battery cables, ignition cable sets, battery box hold-downs, and ignition wires cut into required lengths); Crawford Mfg. Co. v. U. S., 50 F. (2d) 280 (Ct. Cl. 1931) (top covers, back curtains, and seat and floor coverings); S. T. 605, XI-2 C. B. 475 (1931) (windshield glass cut to size, wind wing brackets, rear vision mirrors, and headlight lenses cut from antiglare or beam refracting glass); G. C. M. 11249, XI-2 C. B. 474 (1931) (parts for taxable parts and accessories); S. T. 760, XIII-2 C. B. 405 (1933) (metal base for solid tires); S. T. 606, XI-2 C. B. 476 (1931) (taximeters); S. T. 834, XV-1 C. B. 396 (1935) (baby auto seats, auto beds, and auto hammocks); S. T. 736, XIII-1 C. B. 377 (1933) ("six wheel attachment"). *Held non-taxable as parts or accessories:* Weeks v. U. S., 42 F. (2d) 325 (Ct. Cl. 1930) (supercarburetor); W. M. Dutton & Sons Co. v. U. S., 59 F. (2d) 839 (Ct. Cl. 1932) (hand pump); Frost Gear & Forge Co. v. U. S., 52 F. (2d) 1023 (Ct. Cl. 1931) (pinion, ring, differential, and transmission gears); Cuno Engineering Corp. v. U. S., 43 F. (2d) 259 (Ct. Cl. 1930) (electric cigar lighters, and combination lighters and ash receivers); Durkee-Atwood Co. v. Willcuts, 83 F. (2d) 995 (C. C. A. 8th, 1936) (belts); Martin Rocking Fifth Wheel Co. v. U. S., 60 Ct. Cl. 466 (1925) (semitrailers); Eskstrom v. U. S., 21 F. Supp. 338 (Ct. Cl. 1937) (jumbo transmissions); S. T. 573, XI-2 C. B. 473 (1931) (wrecking cranes for trucks, towing cradles, reboring machines, valve refacing machines, valve grinders, air compressors, paint sprayers, bushings, ball bearings, waterproof cement, paints, lacquers, and gasket cement); S. T. 605, XI-2 C. B. 475 (1931) (headlight lenses cut from plain glass).

[208] INT. REV. CODE §3403(a), (b).

[209] J. W. Cox Motor Sales Co. v. Goodcell, 5 F. Supp. 630 (S. D. Cal. 1933).

[210] G. C. M. 12068, XII-2 C. B. 314 (1932).

[211] American-LaFrance Fire Engine Co. v. Riordan, 6 F. (2d) 964 (C. C. A. 2d, 1925); S. T. 626, XII-1 C. B. 387 (1933).

[212] S. T. 468, XI-2 C. B. 471 (1931).

[213] S. T. 833, XV-1 C. B. 418 (1935).

Radio Sets

The tax[214] relating to radio receiving sets actually applies to the components enumerated in the statute[215] rather than to the complete set itself. A result of this scheme of taxation is that, in particular instances, determination of liability by the taxpayer is beset with difficulties, and auditing of such determination by agents of the Bureau is unduly burdensome. Ordinarily, radio chassis and cabinet are made by different persons; the assembler of the complete set is the manufacturer of the chassis. Of course, if the assembler bills each taxable component separately, difficulties are avoided. But if he sells the set for a lump sum, he is compelled to allocate the total sales price of the taxable components between those which he manufactured himself and those which he purchased taxpaid, and to satisfy the Bureau that the allocation was proper.[216] Unless he can do this, he is required to pay tax on all the taxable components.[217] A solution to this problem would be to broaden this tax, as in the case of automobiles and parts and accessories, to cover complete sets in addition to the components now specified in the law. Although the adoption of this suggestion would reduce the difficulties involved in calculating the tax, it would substantially increase the tax burden, for the sales price of an assembled set, which includes cost of assembly, assembler's profits, and small parts not now taxable, is higher than the aggregate of the sales prices of the components.

Without any apparent justification the law draws a distinction between components for auto radios and components for other radios. A manufacturer may without payment of tax sell the former for use in the manufacturing of complete automobile sets taxable as accessories,[218] whereas he may not sell components for other types of radio, without payment of tax, for use as material or as a component part of a radio chassis.[219] Furthermore, components for auto radios are taxed at a lower rate than that applicable to components for other radios.[220]

Household Refrigerators, Firearms and Ammunition, Matches

Available information indicates that the Bureau has not encountered any particular difficulties in the administration of the statutory provisions imposing the taxes in respect of household refrigerators,[221] firearms,[222] shells,[223] cartridges,[224] and matches.[225] Recently, however, an administrative ruling[226] relating to shells and cartridges has been successfully assailed in a district court.[227] An exemption provision[228] provides that no tax shall apply to the sale of an article for use by the vendee as material in the manufacture of, or as a component part of, an article subject to the manufacturers' excise taxes. The assailed ruling provides that where a manufac-

[214] INT. REV. CODE §3404.
[215] *Ibid.*
[216] S. T. 875, 1938-2 C. B. 396.
[217] *Ibid.*
[218] INT. REV. CODE §3403(c); S. T. 875, *supra* note 216.
[219] S. T. 875, *supra* note 216.
[220] See INT. REV. CODE §§3403, 3404.
[221] *Id.* §3405.
[222] *Id.* §3407.
[223] *Ibid.*
[224] *Ibid.*
[225] *Id.* §3409.
[226] S. T. 551, XI-2 C. B. 483 (1931).
[227] Western Cartridge Co. v. Smith, 404 C. C. H. ¶9818 (D. Conn. 1940).
[228] INT. REV. CODE §3442(1).

turer of shells and cartridges sells such articles to a firearms manufacturer for use in testing his firearms, the sale does not come within the exemption, the reasoning being that the ammunition cannot properly be said to have been used as material in the manufacture of, or as a component part of, the firearms so tested. The federal court, stating that the ruling was at variance with the plain language of the statute, held that the ammunition had been used as a material in the manufacture of firearms.

Electrical Energy

The tax[229] in respect of electrical energy applies only to sales for domestic or commercial consumption and not to sales for resale. It thus discriminates against commercial as compared with industrial users. Moreover, since it does not apply to sales made by publicly-owned electric and power plants,[230] or to states or their political subdivisions,[231] it discriminates against private enterprise. Although the latter statement holds true as a general proposition, a recent amendment[232] necessitates a qualification to the effect that this tax has no application to sales by rural electrification cooperatives or nonprofit corporations. This amendment was obviously made in furtherance of the Government's commendable rural electrification program. In view of the scope of the tax, classification problems as to use have been inevitable. A partial list of recent classification rulings is set forth in the margin.[233] It may be supposed that those buying from power companies have attempted evasion by asserting that their use of energy is industrial. Probably this type of evasion is carried out successfully in numerous instances, for power companies are largely

[229] *Id.* §3411.

[230] *Ibid.*

[231] G. C. M. 13754, XIII-2 C. B. 408 (1933).

[232] Revenue Act of 1938, §713(a), now INT. REV. CODE §3411(c).

[233] *Use held to be commercial or domestic:* S. T. 909, 1940-2 C. B. 309 (churches, convents, charitable organizations, and nonprofit educational institutions, if use is actually domestic or commercial); S. T. 892, 1939-2 C. B. 360 (repair shop, lighting hand laundry, tailor shop, physician's office); S. T. 674, XII-1 C. B. 412 (1932) (cemetery garage); S. T. 652, XII-1 C. B. 411 (1932) (chain store warehouses); S. T. 650, XII-1 C. B. 411 (1932) (furnished by Government for specific charge for use by federal employees in living quarters); S. T. 637, XII-1 C. B. 409 (1932) (dairy producing milk for retail purposes); S. T. 695, XII-2 C. B. 324 (1932) (general farming operations); S. T. 615, XI-2 C. B. 504 (1931) (cold storage warehouse); S. T. 576, XI-2 C. B. 502 (1931) (radio broadcasting station operated for entertainment purposes); S. T. 562, XI-2 C. B. 501 (1931) (hospital operated for profit); S. T. 544, XI-2 C. B. 500 (1931) (church rectory); S. T. 527, XI-2 C. B. 499 (1931) (grain elevator where grain stored for resale or for account of producer); S. T. 525, XI-2 C. B. 499 (1931) (branch house of meat packer used for refrigeration, storage, or distribution); S. T. 518, XI-2 C. B. 498 (1931) (branch office of dairy); S. T. 466, XI-2 C. B. 497 (1931) (motion picture theater); S. T. 464, XI-2 C. B. 496 (1931) (outdoor advertising); S. T. 463, XI-2 C. B. 496 (1931) (branch office of laundry); S. T. 569, XI-2 C. B. 501 (1931) (scavenger company operating under contract with city). *Use held not to be commercial or domestic:* S. T. 892, 1939-2 C. B. 360 (clothing manufacturer; printing establishment; maker of Christmas cards); S. T. 641, XII-1 C. B. 410 (1932) (closed industrial plants); S. T. 695, XII-2 C. B. 324 (1932) (irrigation purposes on farm); S. T. 483, XI-2 C. B. 497 (1931) (railroad dock facilities for loading and unloading ships); S. T. 570, XI-2 C. B. 502 (1931) (nonprofit agricultural fair); S. T. 535, XI-2 C. B. 500 (1931) (nonprofit institution for promotion of knowledge and service in industry); S. T. 545, XI-2 C. B. 500 (1931) (bus company for operations as common carrier); S. T. 576, XI-2 C. B. 502 (1931) (radio broadcasting station owned and operated by educational or religious institution for broadcasting educational or religious programs; regular activities of nonprofit schools, colleges, and universities); S. T. 562, XI-2 C. B. 501 (1931) (nonprofit hospital); S. T. 527, XI-2 C. B. 499 (1931) (grain elevator where grain cleaned, ground, and bleached); S. T. 525, XI-2 C. B. 499 (1931) (branch house of meat packer used for processing meat); S. T. 518, XI-2 C. B. 498 (1931) (pasteurization and bottling milk, and manufacture of butter, buttermilk, and cottage cheese); S. T. 463, XI-2 C. B. 496 (1931) (laundry plant).

dependent upon their customers for information as to use and the task of investigating each case is administratively infeasible. It is plain that the discriminatory effects of this tax could be eliminated only by extending its coverage to all sales regardless of the type of use and by restricting exemptions to sales to governmental bodies.

Gasoline

The basis for the gasoline tax is quantitative.[234] As gasoline prices fluctuate almost daily, because of price wars, unfair competition by so-called bootleggers dealing in contraband gasoline, and similar practices, the quantity basis for tax measurement is more equitable to the members of this industry than would be a price measure. Moreover, this basis greatly simplifies the administration of the statutory provisions relating to this tax; in turn, those provisions do not give rise to serious classification or other administrative difficulties. Furthermore, tax evasion appears to be a minor problem in this field. Industry members, well organized into associations for policing the industry against unfair competitive practices, find it definitely to their interest promptly to report instances of tax evasion to the Government.

Lubricating Oil

A quantity basis[235] for measuring liability is also provided for the tax[236] relating to lubricating oil. The reasons for the adoption of such a basis are substantially the same as in the case of the gasoline tax. Also, in view of the fact that the major members of this industry are well organized to police the industry, tax evasion is not a serious problem, though the Bureau has found instances in which either oil later used for lubrication has been sold tax free under certificates ostensibly for nonlubrication purposes or lubricating oil has been sold as nontaxable grease.

As the statutory provisions relating to this tax do not define the terms "manufacturer," "producer," and "lubricating oils," classification problems have arisen in the course of their administration. A person who merely blends or mixes two or more different grades of lubricating oils is not a manufacturer or producer,[237] but if he employs a process of compounding or other manipulation involving substantially more than the mere mixing of taxable oils, or if he mixes taxable oils with other substances, he is classified as a manufacturer or producer.[238] Similarly, a person who produces reclaimed lubricating oils is a manufacturer or producer within the statute.[239] When a person produces lubricating oil in nonfluid form, he may treat eight pounds of such product as the equivalent of one gallon for the purpose of measuring his liability.[240] An oil having both lubricating and nonlubricating uses may be sold tax free, if the manufacturer obtains an exemption certificate[241] and if the oil is put in a channel of consumption or distribution directed to such other

[234] INT. REV. CODE §3412.
[235] *Id.* §3413.
[236] *Ibid.*
[237] S. T. 548, XI-2 C. B. 450 (1931).
[238] *Ibid.*
[239] S. T. 853, 1937-1 C. B. 323; S. T. 541, XI-2 C. B. 449 (1931).
[240] S. T. 712, XII-2 C. B. 308 (1932).
[241] U. S. Treas. Reg. 44 (1939) §314.43.

use.[242] The types of oils which the Bureau regards as taxable under this tax are indicated by the classification rulings listed in the margin.[243]

Questions have also arisen as to whether lubricating oil obtained by a vendee is nontaxable because used as material in the manufacture of, or as a component part of, an article subject to a manufacturers' excise tax.[244] Lubricating oil mixed with gasoline in the ratio of one part oil to ninety-nine parts gasoline is regarded as being a component part of the gasoline and may therefore be purchased tax free for that purpose.[245] On the other hand, an automobile manufacturer may not purchase tax free, oil for the crank cases of automobiles of his manufacture,[246] nor may a manufacturer of a taxable product avoid tax on oil which will be consumed in the process of manufacturing that product without becoming a component material of the finished product.[247]

Measurement of Price

The purpose of the general statutory provision[248] with respect to the determination of price is to require the inclusion in the selling price of certain charges so closely connected with the cost of manufacture or production as to constitute part of the charge and to authorize the exclusion of other charges which, though they increase the cost to the customer, form no integral part of the sale price.[249] The phrase "in condition packed ready for shipment,"[250] as used in the provision requiring the inclusion in the price basis of charges incident to placing the article in such condition, has reference to an article packed ready for delivery to a customer upon a *bona fide* sale.[251] The charges which may be excluded from the price basis under this general provision all relate to events occurring after the articles leave the point where delivery commences—the factory or warehouse, as the case may be.[252] Freight charges incurred in moving articles from factory to warehouse before sale or from one warehouse to another before sale are accordingly included in the price.[253] But freight charges incurred after sale in shipping articles to customers may be excluded, and in such a case it is immaterial whether the sale was f.o.b. factory, or the manufacturer prepaid such charges, or the sale was made with "freight deductible" or "freight allowed."[254] The expenses and commissions of a demonstrator selling articles subject to this general provision are regarded as part of the selling price.[255] If a manufacturer includes so-called "free" articles in a shipment billed at the regular price, the "free"

[242] S. T. 828, XV-1 C. B. 380 (1935).

[243] *Taxable:* S. T. 505, XI-2 C. B. 448 (1931) (for cutting and machinery operations on metals). *Nontaxable:* S. T. 905, 1940-2 C. B. 305 (agricultural spray oil, air conditioning oil, battery oil, paint oil, putty oil, rust preventive oil, if sold by manufacturer direct to consumer); S. T. 844, XV-2 C. B. 330 (1935) (highly refined special white oil); S. T. 839, XV-1 C. B. 379 (1935) (crude neatsfoot oil and transformer oil); S. T. 803, XIV-1 C. B. 405 (1934) (petrolatum); S. T. 540, XI-2 C. B. 448 (1931) (fatty oils of vegetable, animal, fish, or marine origin).

[244] INT. REV. CODE §3442(1).

[246] S. T. 571, XI-2 C. B. 451 (1931).

[248] INT. REV. CODE §3441(a).

[250] INT. REV. CODE §3441(a).

[252] *Ibid.*

[254] S. T. 513, XI-2 C. B. 511 (1931).

[245] G. C. M. 15661, XIV-2 C. B. 370 (1934).

[247] S. T. 460, XI-2 C. B. 514 (1931).

[249] G. C. M. 21114, 1939-1 C. B. 351.

[251] G. C. M. 21114, *supra* note 249.

[253] *Ibid.*

[255] S. T. 678, XII-1 C. B. 415 (1932).

articles are not regarded by the Bureau as a gift; they simply reduce the price of the entire shipment.[256] Cash discounts and trade discounts are subject to different rules. In the case of a cash discount, the tax is computed upon the total price, but the manufacturer may, in the month when the discount becomes effective, recompute the tax on the net price and take credit for the difference on his return.[257] Of course, if the discount becomes effective in the month of sale, he may recompute his tax on the net price and pay only the amount so computed.[258] Where a trade discount is granted unconditionally at the time of sale, such discount may be deducted from the price and the tax computed on that basis.[259]

Exemption of Subsequent Sales

In conformity with a *dictum* in the *Indian Motorcycle* case[260] to the effect that a manufacturers' excise tax is laid only on the first or initial sale, the Bureau has ruled[261] that payment of the tax with respect to any particular article establishes complete immunity from tax for subsequent resales or uses. Thus, if a manufacturer reacquires a taxpaid article, as a trade-in or otherwise, a subsequent sale by him of that article is not taxable.[262] Questions have also arisen as to taxability of replacements. If a defective article is replaced by the manufacture under a guaranty contract and the manufacturer receives no consideration other than the defective article, the transaction is not a sale and is consequently not taxable.[263] But where an article is sold under a warranty as to quality or service and the manufacturer is required to replace it with a similar article for a payment less than the original price, the transaction is a sale.[264] In such a case, if the tax base is the price, the tax is computed on the second payment; if the base is quantitative, the tax is computed upon that proportion of the total weight of the second article which the reduced payment bears to the regular sales price.[265]

Credits and Refunds

No credit or refund of an overpayment of any manufacturers' excise tax may be made unless the taxpayer establishes in accordance with regulations prescribed by the Commissioner that either he has not included the tax in the price of the article or has repaid the amount of the tax to the ultimate purchaser, or unless he files with the Commissioner the consent of such purchaser to the allowance of credit or refund.[266] The validity of corresponding limitations in former revenue acts has been upheld by the Supreme Court.[267] The earlier limitations provided that the exclusion of the tax from the price or the repayment thereof to the ultimate purchaser should be established "to the satisfaction of the Commissioner." Such phrase, the Court pointed out, did not give the Commissioner absolute authority as to credits

[256] S. T. 484, XI-2 C. B. 508 (1931).
[257] S. T. 616, XI-2 C. B. 512 (1931).
[258] *Ibid.*
[259] S. T. 628, XII-1 C. B. 415 (1932).
[260] Indian Motorcycle Co. v. U. S., *supra* note 162.
[261] S. T. 867, 1937-2 C. B. 505.
[262] *Ibid.*
[263] S. T. 613, XI-2 C. B. 454 (1931).
[264] S. T. 644, XII-1 C. B. 381 (1932).
[265] *Ibid.*
[266] INT. REV. CODE §3443(d).
[267] U. S. v. Jefferson Electric Mfg. Co., 291 U. S. 386 (1934).

and refunds; it was simply admonitive and meant proof which convinces in the sense of inducing belief.[268] Clearly, then, the present requirement that the facts must be established in accordance with the Commissioner's regulations is valid. If, in the case of any tax measured by price, the customer's bill does not indicate whether the tax was included in the total price, it will be presumed that it was so included, unless the presumption is overcome by evidence satisfactory to the Commissioner.[269] A person who purchases a taxpaid article for consumption or for use in the manufacture of other articles and not for resale, is an ultimate purchaser within the statutory provision under consideration.[270]

Sales for Use of the United States

The statutory provision[271] exempting sales of articles for the exclusive use of the United States embraces sales to corporations wholly owned by the United States,[272] but not corporations which are only partly owned by the Government.[273] This exemption also includes sales of articles for use on vessels owned by the United States which are under the control of the Department of Commerce and operated by the United States Shipping Board Merchant Fleet Corporation pursuant to a managing agency agreement.[274] Exemption is also granted to sales of articles for the exclusive use of any state or political subdivision thereof.[275] Cooperative and self-help associations organized for mutual aid and assistance and receiving federal funds for the accomplishment of their purpose are simply organizations of individuals rather than governmental bodies within this exemption.[276] The meaning of the terms used in such exemption are for determination by the Government and may not be restricted by the views of a state.[277] Thus, an irrigation district will be regarded as a political subdivision within this exemption, despite a state court decision to the contrary.[278] Another exemption[279] is granted to sales of articles for use on specified classes of vessels. Included in this group are vessels of war of the United States, although vessels of the Coast Guard may not, during peace time, be so classified.[280]

Articles for Export

The application to specific instances of the constitutional inhibition[281] against taxation of articles exported from any state has in the past occasioned some difficulties, though these have been largely, if not entirely, cleared away by the *Spalding* decision.[282] In that case, the articles were sold by the manufacturer to a commission merchant for exportation to a foreign consignee, the sale being consummated by the delivery of the articles, addressed to the consignee, to the exporting carrier. The

[268] *Ibid.*

[269] S. T. 785, XIII-2 C. B. 413 (1933).

[270] S. T. 690, XII-2 C. B. 341 (1932).

[271] INT. REV. CODE §3442(3). No such statutory exemption is provided for the analogous sugar tax, and exemption is denied by Bureau ruling. P. T. 35, 1937-2 C. B. 530.

[272] S. T. 842, XV-2 C. B. 346 (1935).

[273] *Ibid.*

[274] S. T. 847, XV-2 C. B. 347 (1935).

[275] INT. REV. CODE §3442(3).

[276] S. T. 796, XIV-1 C. B. 411 (1934).

[277] 38 OP. ATT'Y GEN. (1937) 563.

[278] *Ibid.*

[279] INT. REV. CODE §3451.

[280] S. T. 724, XIII-1 C. B. 390 (1933).

[281] U. S. CONST. Art. 1, §9, cl. 5.

[282] Spalding & Bros. v. Edwards, 262 U. S. 66 (1923).

Court held that as the sale was a step in exportation it was not taxable; the possibility that the commission merchant might have changed his mind and diverted the goods into domestic channels was deemed to be immaterial. Thus, if the sale and delivery by the manufacturer actually start the article to its foreign destination, either by the immediate carrier or through connecting carriers, the sale is exempt.[283] It is immaterial that further acts remain to be done before the goods are loaded on the vessel, so long as such acts are only the regular steps to the contemplated result of exportation.[284] Nor is it necessary that the shipment be upon through bills of lading.[285]

Intercompany Sales

Although manufacturers have gone to great lengths to avoid tax through the medium of varying forms of intercompany sales, the Bureau and the courts have made short shrift of most of these subterfuges. The transfer of large inventories by the manufacturer to a sales subsidiary shortly before the adoption of these taxes did not have the desired effect of insulating the manufacturer from taxation with respect to sales made by the subsidiary after the effective date of the tax.[286] The entire scheme was a "colorable sham," an arrangement to avoid tax.[287] The sales subsidiary was simply the instrumentality or agency of the manufacturer.[288] Moreover, Congress clearly foresaw that such stratagems might be resorted to after the enactment of the law and guarded against them by including therein a provision that if an article is sold (otherwise than through an arm's length transaction) at less than the fair market price, the tax shall be computed on the price for which like articles are sold, in the ordinary course of trade, by manufacturers or producers, as determined by the Commissioner.[289] This provision has been invoked in the case of sales between (1) a manufacturing company and a sales subsidiary,[290] (2) a manufacturing company and an affiliated sales company,[291] and (3) a manufacturing plant and a sales plant owned by the same company.[292]

COMMUNICATION FACILITIES

The taxes[293] in respect of telephone conversations, telegraph, cable, and radio messages, and leased wire or talking circuits, have apparently occasioned little difficulty. In any instance the tax applies only to a service for which a charge, in money or money's worth, is made[294] and, in the case of telephone conversations, only if the

[283] T. D. 3495, II-2 C. B. 293 (1922).

[284] *Ibid.*

[285] *Ibid.*

[286] Continental Oil Co. v. Jones, 113 F. (2d) 557 (C. C. A. 10th, 1940); E. Albrecht & Son v. Landy, 27 F. Supp. 65 (D. Minn. 1939); G. C. M. 14526, XIV-1 C. B. 417 (1934).

[287] G. C. M. 14526, *supra* note 286.

[288] E. Albrecht & Son v. Landy, G. C. M. 14526, both *supra* note 286.

[289] INT. REV. CODE §3441(b)(3).

[290] Campana Corp. v. Harrison, 114 F. (2d) 400 (C. C. A. 7th, 1940); Bourjois, Inc. v. McGowan, 12 F. Supp. 787 (W. D. N. Y. 1935), *aff'd*, 85 F. (2d) 510 (C. C. A. 2d, 1936), *cert. denied*, 300 U. S. 682 (1937); S. T. 673, XII-1 C. B. 400 (1933).

[291] Inecto, Inc. v. Higgins, 21 F. Supp. 418 (S. D. N. Y. 1937); S. T. 617, XI-2 C. B. 513 (1931).

[292] S. T. 487, XI-2 C. B. 455 (1931).

[293] INT. REV. CODE §3465.

[294] *Ibid.* See also U. S. Treas. Reg. 42 (1932) art. 4.

charge is above a stated minimum.[295] It is paid to the service company by the person using the communication facility, and by such company is paid over to the Government.[296] Where a telegraph message is phoned over the facilities of a telephone company, the latter acting as agent for the telegraph company, the responsibility for collecting the tax rests with the principal.[297] Even though special statutory provision is not made for the determination of the tax base in cases in which messages are transmitted for the performance of services, as under a contract between a telegraph company and a railroad company for the exchange of services, the Bureau's position[298] is that in such cases each message or conversation must be considered as a separate transmission and the tax computed upon the basis of the regular established charge for the transmission of single messages of the same character. This method of tax determination under similar earlier laws was fully sustained by the courts.[299]

The tax base, in the case of telephone conversations, has been broadened[300] to cover a charge not strictly made for the use of the facilities, the charge exacted for messenger-paging service provided by the company for the convenience of its patrons. The tax[301] relating to leased wires and talking circuits would seem to apply without any limitations, other than the statutory exception as to such facilities when used by specified companies in the conduct of their business as such. Nevertheless, if the terminals of a leased wire service are all located within an area served by a local exchange which does not charge tolls upon messages transmitted between points within such area, it has been ruled[302] that messages over the leased wire are not taxable. The exemption[303] as to facilities utilized in the collection of news for the public press or in the dissemination of news through the public press does not extend to messages by newspapers covering information or items for publication in periodicals published for information on particular subjects or of interest only to particular groups; such messages are not news within the meaning of the statute.[304] Administrative messages of newspapers or press associations[305] are similarly not embraced by the exemption.[306]

BITUMINOUS COAL

The statute[307] imposes two taxes with respect to sales and other disposals of bituminous coal by producers: (1) a tax[308] of one cent per ton, which applies to all producers; and (2) a tax[309] in an amount equal to 19½ per cent of the selling price or fair-market value of the coal, applicable to nonmembers of the Bituminous

[295] INT. REV. CODE §3465(a)(1).

[296] *Id.* §3467.

[297] S. T. 556, XI-2 C. B. 521 (1931).

[298] U. S. Treas. Reg. 42 (1932) art. 6.

[299] Hellmich v. Missouri Pacific R. R., 273 U. S. 242 (1927); Erie R. R. v. U. S., 54 F. (2d) 173 (Ct. Cl. 1931), *cert. denied*, 286 U. S. 553 (1932); Delaware, L. & W. R. R. v. Bowers, 28 F. (2d) 33 (S. D. N. Y. 1926).

[300] S. T. 667, XII-1 C. B. 421 (1932).

[301] INT. REV. CODE §3465(b).

[302] S. T. 893, 1939-2 C. B. 364.

[303] INT. REV. CODE §3466.

[304] S. T. 646, XII-1 C. B. 422 (1932).

[305] *Ibid.*

[306] The tax on the transportation of oil by pipe line is in effect a tax on the use of transportation facilities. Space limitations preclude consideration of the interpretive problems arising under it.

[307] INT. REV. CODE c. 33.

[308] *Id.* §3520(a)(1).

[309] *Id.* §3520(b)(1).

Coal Code. The tax provisions under consideration were originally enacted as part of the Bituminous Coal Act of 1937,[310] the objective of which was the stabilization of the soft coal industry through price-fixing and the elimination of unfair competition.[311] The tax applicable to nonmembers of the Code is clearly not designed merely for revenue purposes. As a matter of fact, such tax, in purpose and effect, is primarily a sanction to enforce the regulatory provisions of the act. Nevertheless, it is constitutional.[312] Congress may utilize the power of taxation as a sanction in aid of the exercise of another power granted to it by the Constitution. The validity of the tonnage tax has also been sustained.[313]

Conclusions

The most outstanding characteristics of the federal consumption excises are their great adaptability to revenue and nonrevenue purposes and the effectiveness with which they may be used in both spheres. Of the taxes considered in this paper, three groups,[314] taken together, produced over $1,600,000,000 in 1940.[315] On the other hand, consumption excises have been utilized, often with drastic effectiveness, to protect the public health or safety, to protect the public against fraudulent practices, to protect certain businesses or industries against others, or to compel compliance with Congressionally determined standards. Generally speaking, such nonrevenue purposes are accomplished by one of three methods: (1) destructive taxation; (2) regulatory provisions linked with tax-imposing provisions; or (3) utilization of the taxing power as a sanction. The advantage of the first method is that it is apparently subject to no special[316] limitations. In any event, there is no case in which an excise tax has been struck down solely because it was destructive. The disadvantage arises from its very destructiveness. It can be used only to destroy. The second and third methods, on the contrary, can be adjusted with utmost nicety to meet an infinite variety of situations. In the case of the second method, the special limitation would seem to be that the statute must be dressed in the language of a revenue measure and the regulatory provisions must bear some reasonable relation to the exercise of the taxing power; that is, such provisions must show on their face that they tend to protect the revenue or to facilitate its collection.[317] The special limitation applicable to the third method is the validity of the Congressionally determined standards. If the latter represent the proper exercise of a Congressional power, the tax is valid as an aid to the exercise of that other power.[318]

[310] 50 Stat. 75 (1937), 15 U. S. C. A. §830 (1939).

[311] See Sunshine Anthracite Coal Co. v. Adkins, 310 U. S. 381 (1940).

[312] *Ibid.*

[313] Winslow Coal Corp. v. Smith, 404 C. C. H. ¶9458 (S. D. Ind. 1940).

[314] Tobacco, liquor, and manufacturers' excise taxes.

[315] Rep. Com'r Int. Rev. (1940) 2, 23, 25.

[316] The word "special" as used in this paragraph has reference to limitations other than the general constitutional limitations that taxes must be uniform and that no tax may be laid on articles exported.

[317] See U. S. v. Doremus, *supra* note 140.

[318] See Sunshine Anthracite Coal Co. v. Adkins, *supra* note 311.